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CORPORATE GOVERNANCE IN JAPAN AND PRESSURE TO CHANGE: A CRITICAL ANALYSIS

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A THESIS SUBMITTED TO THE UNIVERSITY OF DUNDEE IN FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF DOCTOR OF PHILOSOPHY

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Corporate Governance in Japan and Pressure to Change:

A Critical Analysis

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A Thesis Submitted to the University of Dundee in Fulfilment of the Requirements for the Award of the Degree of Doctor of Philosophy September 2009

Declaration

I hereby declare that the author of this thesis, that the work of which this thesis is a record has been done by myself, and that is has not previously been accepted for a higher degree.

Signed Akira Yonekura Date 30 November, 2009

Akira YONEKURA

Certificate

We certify that Akira YONEKURA has worked the equivalent of nine terms on this research, and that the conditions of the relevant ordinance and regulation have been fulfilled.

Signed Sonja Gallhofer Date 30 November 2009

Professor. Sonja Gallhofer

Signed Wm. A. Nixon Date 30 November 2009.

Professor. William. A. Nixon

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ABSTRACT

This study focuses on corporate governance in Japan during the period from 1989 to 2007 when Japan had come under global pressure to change its culturally specific corporate governance system and converge with the Anglo-American corporate governance system. From a critical theoretical perspective the study explores how the U.S. administration, pursuing a neo-liberal agenda, put pressure on the Japanese government to change the laws relating to corporate governance. The study shows how the Japanese government, in recognition of trade dependencies and in pursuance of its on neoliberal agenda, reacted to the demands of the U.S. administration. The study also provides insights into how the *Japan Corporate Governance Forum* in an attempt at self-regulation aimed to establish a set of *Corporate Governance Principles* that would constitute good practice for Japanese companies. The empirical analysis indicates that despite the pressure from the U.S. and the economic crisis that Japan experienced during the period from 1989 to 2007 capture was not complete. Japanese companies are now allowed by law to follow either the Japanese or Anglo-American corporate governance model, but as they have a choice, the majority of Japanese companies still follow the Japanese model of corporate governance. Similarly, the *Japan Corporate Governance Forum* had to revise its *Corporate Governance Principles*, which had advocated the Anglo-American model and to include the Japanese model into their set of principles to reflect contextual developments. The analysis also indicates that in the context of pressure to converge with the Anglo-American corporate governance model the Japanese way of life came under threat because of the different values underpinning the Anglo-American corporate governance model. As a consequence of changing employment practices, emanating from a change in the governance system, more uncertainty was introduced that negatively impacted upon the people living in Japan. The study concludes that any attempt to change the Japanese corporate governance system should adopt a holistic perspective and be concerned to enhance well-being. In this context it is important to also consider the impact that possible changes to the Japanese corporate governance system might have on well-being globally.

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

CHAPTER 1

INTRODUCTION

Corporate governance is high up on the agenda of governments, regulators, corporations and the accountancy profession. Especially since the 1990s, a period that witnessed corporate failures on a global scale, corporate governance has become a key concern of public debate.[1] Failures in corporate governance have posed threats to the hegemonic socio-economic order worldwide. Attempts have thus been made at the level of the nation state as well as at the global level to implement control systems that would ostensibly provide appropriate frameworks for the proper governance of corporations (Clarke, 2007; Solomon, 2007; Monks and Minow, 2008).

Developments in the socio-economic and political spheres have significantly impacted upon corporate governance. The opening up of new markets since the end of the Cold War coupled with an increasing globalizing tendency has ostensibly led to moves to work towards prescriptions for corporate governance systems that would ostensibly facilitate the operation of the global economy. A key focus in this context are apparent moves to converge rules and systems towards a global standard, which on the face of it amounts to Anglo-American corporate governance

[1] This interest in corporate governance is also reflected in the literature. The journal *Corporate Governance: An International Review* was launched in 1993 and *Corporate Governance: The International Journal of Business in Society* in 2001. Noteworthy are also special issues on corporate governance such as, for example, *Accounting and Business Research* in 1993 and the recent special issue of *Accounting, Auditing and Accountability Journal* in 2008.

practices (Gallhofer and Haslam, 2007). Policy makers, accountancy professions and governments of individual nation states have on the face of it come under varying pressure to change their corporate governance systems so as to reflect this global standard.

This study focuses upon corporate governance in Japan during the period from 1989 to 2007 in the context of the above developments. Japan is an especially worthwhile focus as its conventional economic success after the Second World War has attracted much interest, from academics and practitioners alike, in what was perceived to be the 'Japanese way' of business management.[2] There had emerged a sense that Japan is different and that the differences have enhanced its economic success. This perception of Japan, however, changed when the country's economic boom (at its highest by the end of 1989) came to an abrupt halt with the bursting of the bubble economy in 1990 and with the Japanese economy subsequently going into recession. In the context of this economic crisis, which lasted until the beginning of the twenty-first century (Cargill and Sakamoto, 2008), with large Japanese companies liquidating and illegal payoff cases being exposed (Cooke and Sawa, 1998) and coupled with an increasing concern with the interdependencies of what is now perceived a global economy, the Japanese corporate governance system had become subject to critique from inside as well as outside of Japan (Hoshi and Kashyap, 2001, p. 1). When the various corporate scandals emerged[3],

[2] See, for example, Clegg and Kono (2002, p. 272), who refer to 'many books in praise of Japanese management' having been published during the 1980s.
[3] For example, the collapse of *Yamaichi Shouken* (Cooke and Sawa, 1998).

questions were raised about the traditional[4] Japanese corporate governance system. The system, which had been praised as having been a major contributor to facilitating the growth of the Japanese economy, now came to be seen as a contributory factor to the crisis of the early 1990s and the difficulties succeeding it (Cooke and Sawa, 1998). The questioning of the Japanese corporate governance system further intensified in light of corporate failures in the Japanese financial and a growing worldwide concern with corporate governance (Jackson and Miyajima, 2008). Because of the above contextual developments, the period from 1989 to 2007 has been chosen as the period of focus for this study. This period, which witnessed the height of the bubble economy, a severe economic crisis and the height of neoliberal reforms - in many ways a crisis context - can provide interesting insights into how corporate governance practices and context interrelate. Further, it can show how changing one part of the corporate governance system because of pressure to do so can variously affect other systems (for example, the corporate system) and how this in turn can impact on a country's culture and on people's well-being.

Critics of the Japanese corporate governance system put particular emphasis on the following characteristics of the Japanese corporate system, which for them impacted negatively on the effectiveness of the corporate governance system: the powerful role of and influence upon management by the banks as the major

[4] The Japanese corporate governance system that had developed since the nineteenth century and that was in place in 1989 is variously referred to as the "traditional" or "conventional" Japanese corporate governance system (for example, Hoshi and Kashyap, 2001). This study uses these terms interchangeably.

providers of capital, the cross-shareholdings, and, the system of corporate and external auditors as specified by the *Commercial Code* (Cooke and Egawa, 1998). By the end of the 1990s the specific concerns about the Japanese corporate governance system and the Japanese corporate system had developed into a concern about the Japanese economic system more generally. Hoshi and Kashyap (2001) comment on these developments as follows:

> By the late 1990s many analysts were arguing that Japan's problems could not be solved using the policies that have become commonplace during the preceding four decades of mostly boom. To some observers, this means Japan should drop everything that characterized its "traditional" economic system. All the "Japanese" aspects of the system were to be purged, so that the economy could become more open, free, and international. In short, it is common to assert that Japan's economy must undergo a "globalization", which often is meant as the equivalent of "Americanization". (Hoshi and Kashyap, 2001, p. 1)

The same argumentation was made in relation to the Japanese corporate governance system with apparent global pressures on Japan to change its corporate governance system in line with practices developed in Western economies such as the US and the UK, governance systems that are reflective of Western cultural values and ways of organising socio-economic life (*ibid.*).

Focusing on the context outlined above, the aims of this study here are twofold: first, to gain insights into how in a global context pressure was exercised on Japan to change the Japanese corporate governance system and to converge with the Anglo-American corporate governance system, and, second, to gain insights into how constituencies that were variously affected by changes in the Japanese corporate governance system responded to the pressure to change. In particular, this research explores the following and related questions: What happens to the specific characteristics of the traditional Japanese corporate governance system and its related corporate system in the context of global pressure to change and adopt the Anglo-American system of corporate governance? What are the threats to and opportunities for the local including culturally specific aspects of the Japanese corporate governance systems in the context of global pressures to adopt a corporate governance system underpinned by different cultural values reflecting the prevalent global hegemony? What are and will be the consequences of the implemented and proposed changes on the well-being of the people living in Japan? And, what are possible ways forward for the Japanese corporate governance system in the context of global pressures to adopt the Anglo-American corporate governance system?

These questions are explored in two case studies: first, an analysis of the way in which corporate governance issues featured in the bilateral trade negotiations between Japan and the U.S. during the period from 1989 to 2007, and, second, an analysis of the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* and their various amendments during the period from 1997 to 2006. In order to better embed these two case studies in the public debate on corporate governance in Japan during the period from 1989 to 2007, an analysis of the key issues featured in the reporting on corporate governance of Japanese newspapers and in public corporate governance pronouncements of Japanese constituencies is also carried out. Employing a critical theoretical perspective on corporate governance, the study offers a holistic analysis of corporate governance as a social practice embedded in both a specific national corporate and socio-economic and political context and a global socio-economic and political context. The critical theoretical perspective, which informs the analysis, draws particular attention to different power relations in the global context, addresses tensions between local (in the case of the study here, Japanese) cultures, practices and traditions and the global hegemonic (in the case of the study here, U.S.) culture, practices and traditions, and is concerned to consider ways forward. Having outlined the focus and aims of the study, the remaining part of this chapter provides a brief overview of the contents of chapters two to nine.

Chapter two elaborates the critical theoretical perspective underpinning the analysis of the empirical material. It summarises the main characteristics of this theory showing its roots in Frankfurt School theorising and more recent amendments, which reflect a response to some aspects of postmodern critique. The chapter also provides an overview of the two key perspectives on corporate governance that can be found in the literature: the agency theory perspective and the stakeholder theory perspective. The chapter then outlines a critical theoretical perspective on corporate governance.

Chapter three offers a review of the literature. In this review key trends, issues and themes in the literatures in the English and Japanese language on corporate governance in Japan are identified and summarised. Reflecting the interdisciplinary character of this study, the chapter discusses contributions to the literature from a variety of disciplines, including, accounting and finance, economics, management, human resource management, law, politics, sociology, international relations and Japan Studies. The chapter offers a critical appreciation of the English as well as the Japanese literature and considers the way in which both literatures relate to the Anglo-American model of corporate governance as well as to the Japanese model of corporate governance. The chapter ends by outlining the contribution to knowledge of this study.

Chapter four addresses issues of methodology and method from a critical theoretical perspective. It provides some methodological considerations and outlines how theory, methodology and method are interrelated and offers a brief elaboration of ontological and epistemological assumptions. The chapter also explains the choice for the particular case study methodology adopted in this study and briefly outlines its main characteristic. The chapter ends with a brief overview of the methods employed in the analysis of the empirical material and offers a rationale and brief overview of the sample of newspapers analysed in this study.

Chapter five provides insights into the development of the Japanese corporate governance system with reference to the context in which it is embedded. The chapter covers the period from the nineteenth century to 2007. Appreciation of this period in the history of Japan is of importance for an understanding of the issues currently informing current debate on corporate governance in Japan. Particular emphasis in this chapter is placed on the way in which developments in the socio-economic and political context have led to changes in the corporate governance system. The analysis also emphasises the cultural dimension of Japanese corporate governance.

Chapter six provides insights into the broader corporate governance context of Japan during the period from 1989 to 2007. It initially offers a critical comparison of the Anglo-American corporate governance system with the Japanese corporate governance system. This comparison highlights the way in which the characteristics of both corporate governance systems are shaped by their respective contexts and the philosophies and ethics that underpin them. The chapter also offers a brief outline of the characteristics of the Japanese corporate system and Japanese capitalism. Based on an analysis of documents, the chapter then elaborates the key issues that were addressed in the corporate governance pronouncements of various Japanese constituencies and summarises the key issues addressed in the public discourse based on the insights gained from a content analysis of general and financial Japanese newspapers.

Chapter seven explores how corporate governance issues were embedded in the bilateral trade negotiations between Japan and the U.S. in the period from 1989 to 2007. It gives particular attention to the pressure placed upon Japan by the U.S. to change its specific accounting disclosure practices and corporate governance system so as to reflect the (U.S. orientated, Anglo-American) global standard. The chapter indicates the sense in which in the context of trade negotiations from the late 1980s onwards, the U.S. administration has consistently put pressure on Japan to converge with this global standard and offers an interpretation of how the Japanese government has responded to such pressure. Adopting an historical perspective, it unravels how demands made by the U.S. administration found their way into Japanese law. Revisions of the 1993 *Commercial Code*, for example, reflected a response to U.S. demands. Most importantly, the 2002 revision of the *Commercial Code* allowed Japanese companies to either follow the Japanese or Anglo-American model of corporate governance. The chapter explains that although it appears that the U.S. administration had been successful in changing the Japanese corporate governance system, capture was not complete. A key reason in this respect is the choice of governance system that the law allows. As a consequence, many Japanese companies have not yet adopted the Anglo-American corporate governance system. This can be understood as a form of resistance to global hegemonic pressure and an attempt to preserve local practices.

Chapter eight analyses the developments and amendments of the *Corporate Governance Principles* of the *Japan Corporate Governance Forum*. The *Principles*, which constitute an attempt of self-regulation by a private group of industrialists, academics, lawyers and journalists, provide interesting insights into how the pressure to change the Japanese corporate governance system so as to reflect the Anglo-American system was perceived by a key Japanese constituency, namely the

Japan Corporate Governance Forum. The *Japan Corporate Governance Forum*, in aiming to arrive at a set of principles that would constitute good corporate governance practice for Japan, achieved international recognition, most importantly from CalPERS. It has also been argued that its Principles were reflected in the 2002 revision of the *Commercial Code*. Through an analysis of the various revisions of the *Principles* the chapter provides insights into how the differences between the two corporate governance models were articulated and what were perceived to be reasonable ways forward in the context of pressures to change. The chapter also shows how in light of contextual developments the Anglo-American corporate governance model was variously embraced. In the first draft of the *Principles* there was a clear concern to preserve at least some particularities of the Japanese corporate governance and corporate system, such as for example, life-long employment and to improve others, such as for example, the board of corporate auditors. The emphasis, however, shifted towards an embracing of the Anglo-American system, which was advocated as best practice in 2001. Interestingly, because of further contextual developments, most importantly the 2002 revision of the *Commercial Code*, the *Principles* had to be amended. To advocate the Anglo-American corporate governance system as best practice had become unattainable in a context where companies were allowed to either follow the Japanese or Anglo-American model. Reference was thus made again to the Japanese model in a new version of the *Principles*. In addition and reflecting contextual development, corporate social responsibility was included in the *Principles*.

Chapter nine summarises the insights of the analysis of the empirical material especially with reference to changes to the Japanese corporate governance system in the context of global pressure to change and to converge with the Anglo-American corporate governance system. It considers the threats to and opportunities for the culturally specific aspects of the Japanese corporate governance system emanating from the pressure to change and to adopt a corporate governance system that is underpinned by different values. The chapter is also concerned to consider manifest and potential consequences on the well-being of the people living in Japan emanating from changes to the Japanese corporate governance system. And, the chapter offers suggestions for possible ways forward for the Japanese corporate governance system in the global context. It also points to the need for the West to critically reflect upon its own practices and begin to question and challenge the taken-for-granted supremacy of the Anglo-American model of governance. In concluding, the chapter points to further areas of research.

CHAPTER 2

TOWARDS A CRITICAL THEORETICAL PERSPECTIVE ON CORPORATE GOVERNANCE

This study pursues a critical theoretical perspective on corporate governance. The basic character of a critical theory of society and society's practices (including its practices of governance and accounting) was expressed by Marx in his famous dictum that philosophers have aimed to understand the world but the task, however, is to change it. This basic perspective, which encompasses both understanding and intervention, is substantively influenced by Hegelian thought with its emphasis on context, tensions and dynamics. This line of critical thinking, which is critical and interpretive (Bernstein, 1976; Burrell and Morgan, 1979; Held, 1980), has been refined in various ways since Hegel and Marx (Alvesson and Willmott, 1996, p. 67; Roslender, 2006). A key moment in the development of such critical theorising has been the emergence of the Frankfurt School, where a supradisciplinary approach, concerned to focus on wide-ranging themes, was promoted (Held, 1980). This perspective has been concerned to be open and non-dogmatic and to grow through engagement with other perspectives and refinement (Alvesson and Deetz, 2000). In substance, following this critical theory, a critical supradisciplinary approach informs this analysis. The structure of the chapter is as follows: a brief historical overview of the main influences that have shaped the critical theory mobilised in this study; an outline of the key elements of this critical theory; an elaboration of the way in which this particular critical theory shapes the view taken on corporate governance in this study.

2.1. Elements of the critical theory applied in this study

In 1923 the Institute for Social Research was founded in Frankfurt. The founders and subsequent members of the Institute for Social Research have become known as the Frankfurt School of Critical Theory (Calhoun and Karaganis, 2006). The Frankfurt School and social theorists associated with it (for example, Max Horkherimer, Theodor Adorno and Herbert Marcuse) and further developing it (such as, for example, Jurgen Habermas) are often collectively referred to in terms of Critical Theory. Alvesson and Willmott (1996, p. 67), for example, note that 'the term Critical Theory is used to refer to scholars and commentators who are closely related, or strongly sympathetic, to the work of the Frankfurt School'. Calhoun and Karaganis (2006, p. 179), however, see limitations in such a specific and narrow usage of the term:

> The core members of the early Frankfurt School included Max Horkheimer, long-time director of the Institute, Theodore Adorno and Herbert Marcuse. While the label 'critical theory' is sometimes used synonymously with their work (and they sometimes claimed to be the only truly critical theorists of their generation), it is misleading to use the label for the Frankfurt School exclusively. This makes critical theory appear to be much more rigid and fixed than it ever was or can be. Not only are there innovations by new generations of theorists – as with any vital theoretical tradition – the Frankfurt School founders insisted on a conception of critical theory as always embedded in processes of historical change, providing both an analytical perspective on the present and a lever on the future.

Calhoun and Karaganis (2006, p. 181) further elaborate upon the position taken by the Frankfurt School regarding the development of theory:

> The first generation of Frankfurt School critical theorists always insisted on the historical embeddedness of theory. They recurrently criticized those who presented theory as though it could adopt a position outside of history, and those who imagined that theory would somehow explain social change without itself being transformed by it.

In their overview, Calhoun and Karaganis (2006, pp. 179-180) Critical Theory distinguish between the first generation of the Frankfurt School, which encompasses the initial founding members of the Institute of Social Research; the second generation of the Frankfurt School, which offered 'direct extensions of the Frankfurt School legacy' (*ibid.*, p. 180), the most well-known member being Jurgen Habermas; and, a third generation with the most well-known members being the German theorist Axel Honneth and the U.S. theorist Seyla Benhabib. Latterly, researchers aligned to or working out of a Critical Theoretical perspective have engaged with and refined their work through engagement with postmodern thought (Best and Kellner, 1991; Agger, 1998; see also Gallhofer and Haslam, 2003). Highlighting the diversity of positions taken by Critical Theorists, Calhoun and Karaganis (2006, pp. 179-180) also point out that other theorists have engaged and aligned themselves with the Frankfurt School without ever having been members of the Institute of Social Research (for example, Walter Benjamin). The study here is cognisant of the argumentation developed by Calhoun and Karaganis and therefore uses the construct *critical theoretical* perspective in the broad sense of including Frankfurt School theorising and later refinements of Frankfurt School theorising especially through an engagement with postmodern insights (see below) (Gallhofer and Haslam, 2003).

According to Alvesson and Willmott (1996, p. 67), a core concern may be identified within Critical Theory despite the diversity of positions taken by its representatives:

> At the core of Critical Theory is a concern to develop a more rational, enlightened society through a process of critical reflection upon the organization and efficacy of existing institutions and ideologies. The considerable diversity of the School is integrated around a common desire to mobilize the potentials of critical reasoning to question and transform oppressive features of the modern world by means of 'a non authoritarian and non-bureaucratic politics' (Held, 1980: 16; cited in Alvesson nad Willmott, 1996, pp. 67-8).

As was noted earlier, there is continuity between Frankfurt School theorising and left-Hegelian (especially Marxist) theorising in terms of the critical dimension of the research and the concern to engender change (Alvesson and Willmott, 1996, pp. 68-9). They differed, however, from Marx in terms of who they perceived to be the agent for change. Although believing in possibilities of emancipatory change, for members of the Frankfurt School the proletariat did not *necessarily* have the required power and vision to become the key agent for change as envisaged by orthodox Marxism (Alvesson and Willmott, 1996, pp. 68-9; see Gallhofer and Haslam, 2003). Alvesson and Willmott (1996, p. 69) argue:

> Declining to align themselves with interests ascribed to the proletariat by orthodox Marxists, members of the School nonetheless identified themselves with the critical, emancipatory *intent* [emphasis in the original] of the Marxian tradition. But...instead of focusing upon the revolutionary potential ascribed to the proletariat, attention was directed to any and all

> individuals who – feeling frustrated, oppressed and confused by the contradictory claims, perverse priorities and divisive effects of modern capitalist societies – were potentially receptive to the revitalization of Enlightenment ideas about autonomy and the development of responsible citizenship. [5]

The emphasis on an emancipatory commitment of the researcher distinguishes Critical Theory from positivist theory: research reflecting an emancipatory intent is explicitly value-laden and contrasts with positivist research, which claims to be neutral (Burrell and Morgan, 1979). It is this critical, emancipatory intent of Frankfurt School theorising that is a key orientation of the critical theory utilised in this study. Implied by the emancipatory intent is a concern with change, that is, a general concern to make things better, to improve things (Gallhofer and Haslam, 2008). Having delineated a key orientation of critical theory informing this study a brief discussion of the main themes of this critical theory is offered. There are two parts to this discussion of key themes: first, themes developed by the first generation of the Frankfurt School are summarised; second, themes emerging out of or coming to be emphasised after an engagement with postmodern theorising and postmodern critique are elaborated.

Social practices are understood to be political, cultural and ideological phenomena, which are embedded in a particular socio-economic, political and cultural context. Context and social practices interact with each other, that is, the context influences and is reflected in social practices and social practices affect and shape the context.

[5] The Frankfurt School hung on to a concern to pursue a rescuing critique of the Enlightenment and modern ways (Held, 1980).

Critical Theory is interested in gaining insights into the interrelationship of social practice and context. As Gallhofer and Haslam (2008, p. 12) have explained:

> Critical theorising encourages a *critical* [emphasis in the original] standpoint vis-à-vis the phenomena and practice studied as well as the context in which they are located. This implies recognition that social phenomena and practices and contexts have negative as well as positive potentialities the realisation of which depends on the particular interrelationship between phenomena, practices and contexts. It is the task of the researcher to identify the positive or what we term *enabling* or *emancipatory* [emphasis in the original] potentialities through critical social analysis and to consider their realisation in projects concerned to work towards a better world for all, that is, to enhance well-being globally.

Critical Theory is critical of the status quo, which includes context as well as social practices. Of particular concern are unequal power relations, which impact on the way in which an individual or a group of individuals are able to pursue their own perceived interests and realise their potential. Critical Theory, however, is not only concerned 'to point to deficiencies in a particular society, including its dominant thought patterns, but to identify as yet unrealized potentials that are locked, as it were, within existing institutions and stocks of knowledge' (Alvesson and Willmott, 1992, p. 10).

Critical Theory also challenges seemingly neutral and taken-for-granted practices, such as, for example management and accounting. According to Alvesson and Willmott (1992, p. 10) 'CT insists on the political nature of what is seemingly neutral or technological and highlights the dangers of technocracy for human autonomy and responsibility'.

Critical Theory questions instrumental rationality, that is, a means-end rationality whereby the means become more important than the initial goals. And, relatedly, there is a concern to challenge the notion that everybody should pursue their own narrow interest so as to somehow leave everybody better off (Held, 1980).

Critical Theory puts an emphasis on the relevance of historical analysis. It sees potentialities in an understanding of the past and holds that history deepens an understanding of the present as problematic (Gallhofer and Haslam, 1993). As has been elaborated above, members of the Frankfurt School have pointed to the way in which theory develops within a context and thus changes as the context changes. Here an attempt is made 'true to the tradition of Critical Theory, which has always encouraged creative borrowing from diverse empirical and philosophical disciplines' (Alvesson and Willmott, 1992, p. 3) to engage with developments in social theorising and to consider how Critical Theory may be modified so as to better facilitate the analysis of social phenomena.

Researchers have argued that aspects of more recent theorising, especially postmodern, postcolonial and feminist theorising, may be usefully applied to refine Critical Theory (Kellner, 1989; Best and Kellner, 1991; Agger, 1998; Gallhofer and Haslam, 2003). The three key issues in this respect are: a critique of problematic universal theorising, the notion of giving the other a voice and a kind of dialectical thinking termed continuum thinking in the context of worrying about universalism.

Postmodern theorising has argued that theories influenced by Enlightenment thinking – including Critical Theory – have tended to use universal categories and favoured grand narratives. Emancipation, the key emphasis of Critical Theory, according to postmodern theorising is an example of a universal category: As a universal category emancipation in the context of Critical Theory thus fails to recognise the multiplicity of oppressions and repressions and hence emancipations (Gallhofer and Haslam, 2003). Relatedly, it was argued that the universal view of emancipation reflected Western, and especially continental European, thinking and values. Based on their critique of universal theorising, many postmodern theorists concluded that universal categories and associated grand narratives should no longer be employed in research and policy. Instead, the emphasis should be on the particular and judgment should be reserved to those being part of the particular. Critical Theorists have responded to this challenge of postmodern theorising in a way that still makes it possible to have emancipation as a key guiding principle of Critical Theory but at the same time aims to avoid the negative side of universal theorising as outlined by postmodern theorists. In this respect, Gallhofer and Haslam (2003) have argued that the notion of differentiated universal is a way of aligning the universal with the particular without losing its radical political dimension. Seeing emancipation as a differentiated universal would imply the following. The notion of emancipation, as the act/process of freeing oneself from repression, oppression and alienation, is still a universally applicable notion for all human beings. According to this line of argument, emancipation would still lead to an increase in well-being, that is, making things better, a main concern of Critical

Theory. Within this universal there is, however, difference in terms of the types of repressions, oppressions and alienations and emancipations that people experience. The difference in repressions, oppressions and alienations and emancipations is the result of, for example, different contexts (such as, cultures, histories, political systems, states of the economy) and individual experiences and characteristics (such as, for example, age, gender, sexual orientation, race and ethnicity) of human beings (Gallhofer and Haslam, 2003).

Strands of postmodern, postcolonial and feminist theorising have also pointed to the way in which Critical Theory tended to silence the other or the local, especially through being Westerncentric and universal in theorising and prescription for change. Relatedly, Western institutions and practices have been seen as imperialistic and thus as facilitating repressive relationships between the imperial power and its dependent colonies. Further, such dependence, it has been argued, is sustained even after independence of colonies through Western institutions and practices (Calhoun, 1995; Gandhi, 1998; Loomba, 1998; for the case of accounting and the accountancy profession see, for example, Annisette, 2000, 2004; Abdul-Rahaman, 1998). It is especially important to facilitate and listen to local voices and to appreciate the insights of different cultures in our current global context in which there is a tendency to see Western ways as more advanced and superior. Further, open engagement with the other should be also emphasised as such co-operation facilitates the envisioning of a better world and strategies for change that will better ensure that well-being is enhanced globally (Gallhofer and Haslam, 2003, 2009).

A further insight of recent theorising that is applied here to modify Critical Theory is continuum thinking in the context of change and difference. As Gallhofer and Haslam (2003) have explained, this concept, which was especially mobilised by feminist theorists, may helpfully be employed in further enhancing the way in which Critical Theory engages with change. Continuum thinking in terms of change means that we move on a continuum from the status quo to a desired future state. This view emphasises the need to go beyond the revolutionary tradition and contrasts with a revolutionary notion of change where one can move immediately from the status quo to the desired future state. Gallhofer and Haslam (2003) also point out that as one moves along a continuum towards the desired future state the characteristics of the envisioned future state changes itself.

2.2. DELINEATING A CRITICAL THEORETICAL PERSPECTIVE ON CORPORATE GOVERNANCE IN JAPAN

This part of the chapter is concerned to delineate a perspective on corporate governance, which reflects the general themes of the Critical Theory outlined above. In order to show how this perspective builds upon and goes beyond current perspectives on corporate governance a brief overview of the two perspectives on corporate governance given most emphasis in research (conceived of in terms of the agency theory perspective and the stakeholder theory perspective) is initially offered. Based on a critique of these perspectives, which highlights their limitations, a critical perspective on corporate governance is outlined.

2.2.1. Agency Theory and Corporate Governance

Although Clark (1998) pointed to a lack of an integrated theory on corporate governance, two main positions may be identified that underpin research on corporate governance: an agency theory perspective and a stakeholder perspective. As Letza et al (2004) have argued, most of the research on corporate governance in the English language reflects either an agency theory perspective or a stakeholder theory perspective. According to Mallin (2004), an agency theory perspective on corporate governance has manifested as the mainstream approach with the stakeholder perspective being seen as an alternative to an agency theory perspective (see also Letza et al, 2004).

The emergence of agency theory here is linked to developments in the socio-economic sphere. The development of capitalism coupled with significant socio-economic changes has led to the emergence of the large joint-stock corporation since the Industrial Revolution. In the context of significant changes in the structure and ownership of corporations a critique emerged of the neoclassical view of the firm. In neoclassical economic thought a firm had been seen as a 'black box', that is an entity, which attempted to maximise its profit (Jensen and Meckling, 1976). Neoclassical economists' primary concern was the role of the market because they conceived the market as a mechanism functioning to distribute and redistribute wealth and therefore they did not take an interest in the function and structure of the firm (Kikuzawa, 1997). Berle and Means (1932), however, in their *The Modern Corporation and Private Property*, developed an argument against this notion whereby a firm attempted to always maximise its profit. They argued that in a modern large corporation share ownership was spread among a large group of individual investors and none of these investors could hold enough shares to be able to control the firm. As a consequence of dispersed ownership '[c]ontrol is held by a self-perpetuating and unaccountable group of top managers, even though its own shareholdings may be negligible' (Leech, 1987, p.536). Berle and Means (1968) further argued that the interests of managers and the interests of the owners of the corporation might differ (see also Bricker and Chandar, 2000). Their research and argumentation has had a far-reaching influence on studies of corporations.

More than forty years after the publication of Berle and Means' (1932) seminal work, Jensen and Meckling (1976) built upon and further developed Berle and Means' elaborations upon the modern corporation. The theory they developed in this context has become known as agency theory. Jensen and Meckling (1976, p. 3) defined the agency relationship as '[a] contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent'. This relationship is different from the employer-employee relationship because according to their definition, the principal(s) devolve(s) power to the agent. In the employer-employee relationship, the employer can instruct the employee whenever he or she wants; however, in the principal-agent relationship the principal cannot constantly direct the agent. Jensen and Meckling (1976) thus postulate that all participators in a company try to maximise their *own* benefit, that is, the agent does not always act so as to maximise the principal's wealth. Based on this argumentation it is therefore important for the principal to induce the agent to pursue the principal's interest. Jensen and Meckling (1976) call this the 'agency problem' and the expenditure to resolve the problem 'agency cost'. They identified three types of agency costs: 'the monitoring expenditures by principal', 'the bonding expenditures by agent', and 'the residual loss' (*ibid.*, p.4). They claim that although it is impossible to reduce agency costs completely, it is possible to reduce them to a low level by accepting to bear certain costs. According to agency theory 'establishing appropriate incentives for the agent' and 'incurring monitoring costs' (*ibid.*, p.4) bring about a solution to agency problems. In addition to the problems identified by Jensen and Meckling (1976), other problems have subsequently been pointed out, such as, for example, different attitudes towards risk and information asymmetry (Mallin, 2004). Although agency theory has been criticised for reducing the complex web of relationships constituting the firms into only the relationship between two participants, reducing the costs and conflicts between managers and shareholders became the central issue in research and policy debates concerned with making firms more efficient entities.

Agency theory as outlined above has been especially developed by researchers from Anglo-American countries, such as the U.S., the U.K., Canada and Australia because as Turnbull (1997) has argued the agency problem considered in its own terms is more serious in Anglo-American countries than in continental Europe and Japan.[6] Turnbull (1997) refers to four reasons in this context: first, shares are widely spread in Anglo-American countries; second, there has been no supervisory board in these countries; third, the laws even tend to impose legal controls upon shareholders not to stand together to urge managers to improve their policy; and, fourth, the insider trading law also limits access to certain information that may be helpful for monitoring and supervising the board of directors.

Agency theory has significantly impacted upon and framed debates and research on corporate governance. Key to the debates on corporate governance from an agency theory perspective is the assumption that managers are not willing to pursue shareholders' interests because of several reasons. Denis (2001, p. 193), from the point of view of a financial economist, refers to three possible reasons for why conflict may arise between managers and shareholders: first, '[m]anagers' desire to remain in power'; second, '[m]anagerial risk aversion'; and, third, '[f]ree cash flow'. 'Managers' desire to remain in power' refers to managers' attempts to stay in their position as long as possible. This can lead to a serious conflict between managers and shareholders when the management team proves to be inefficient in

[6] For an overview of the application of agency theory in accounting research see Subramaniam (2006).

terms of increasing corporate value. 'Managerial risk aversion' suggests that as the manager of the firm is responsible for everything happening in the firm and belonging to the firm, the manager is generally circumspect in making decisions. Shareholders, in contrast, nowadays have spread their investment over several industries and, therefore, one single project does not necessarily constitute a significant risk in terms of affecting shareholders' wealth substantially. As a consequence, shareholders want managers to invest in 'positive net present value (NPV) projects' (Denis, 2001, p.194), whereas, managers are concerned with projects' prospects and risks so as to avoid damaging their firms. Judging from these attitudes, it is evident that managers and shareholders have different interests, which can bring about a conflict of interest between them. 'Free cash flow' is defined by Jensen 'as cash flow generated by the firm in excess of the amount required to fund all available positive NPV projects' (Denis, 2001, p. 194). Free cash flow may lead to another conflict between managers and shareholders because shareholders wish for a part of the free cash flow to be returned to them through either dividends or the purchase of treasury stock. Managers, however, may want to keep any free cash flow or prefer to reinvest it into another project because they may want to grow the companies rather than maximise shareholders' wealth (*ibid.*).

Another argumentation of agency theory, which has significantly impacted upon debates and research in corporate governance, is Jensen and Meckling's (1976) claim that it is possible to mitigate agency problems by establishing a monitoring system and by giving managers incentives. In connection with the monitoring function it has been argued that assuring the independence of the board of directors through board membership of non-executive directors is essential in mitigating agency problems (see, for example, Fama and Jensen, 1983).

This view is reflected in the 1992 report of the UK committee on corporate governance chaired by Sir Cadbury. The Cadbury report recommended 'to decentralise power within the firm and to increase the role and independence of non-executive directors in the monitoring of executives' (Keasey et al, 2005, p.5). The Cadbury Report further advised that the Chief Executive Officer (CEO) should not also act as the chairman of the board of directors (*ibid.*). In the U.S., the New York Stock Exchange has required audit committees to be created that consist of a majority of outside directors since 1978 and the Security Exchange Commission (SEC) also has required establishing compensation committees since 1992 (Blair, 1995). These series of changes had been introduced so as to enhance the status and effectiveness of the board of directors as a device for monitoring executives and management. There are, however, some critical views on the issue of the effectiveness of the board of directors within agency theory's own terms. Tamura (2002), for example, points to four issues, which in his view negatively impact upon the effectiveness of non-executive directors: first, many non-executive directors are busy because many of them are incumbent CEOs of other companies and therefore might not be able to spend enough time and energy on the duty as non-executive director; secondly, they have a desire to remain in their office because in the U.S. to serve as a large company's director is regarded as a great honour and therefore they might tend not to raise objections to the CEO so as to secure their position; third, there is a high probability that CEOs might appoint their close friends to the position of non-executive director. Tamura (2002) remarks that the above issues may lead to the malfunction of the board of directors, even if the board also consists of outside directors (*ibid.*). Similarly, although Blair holds that '"[i]ndependent" in principle, these outsiders may in fact know little about the business of the firm and are therefore very dependent on the CEO and other senior officers of the company to tell them what is going on' (Blair, 1995, p.78). She further argues that '[o]ne of the most important problems impairing the function of boards is the lack of consensus not only about their goals, but also about whose interests they should serve' (*ibid*, p.79).

Research and debates on corporate governance reflect the argumentation of agency theory that in order to reduce agency problems agents should be given incentives. Research and policy makers have in this context considered the usage of stock options as an appropriate incentive mechanism. Stock options, which can be defined as 'the right to purchase shares (stock) at a specified exercise price over a specified time period' (Mallin, p.111), are seen as a means of encouraging management to increase the value of the firm. This line of argument has, however, been subjected to criticism. Keasey et al (2005), for instance, make the point that in the 1990s the dynamic growth of the stock market in the U.S and the U.K. brought benefits not only to management who performed well but also to management who did not perform well as they were able to manipulate share prices so as to achieve a higher share price just before the exercise date of their stock options. Researchers have thus argued that these particular remuneration arrangements can have unintended behavioural effects (see, for example, Keasey et al., *ibid*).

A more basic critique reflects uncertainty and controversy about the purpose of a firm as defined in agency theory. In the context of agency theory a firm is understood to be an organisation that is required to maximise shareholder wealth. Yoshimori (2004), however, points to an ambiguity concerning the phrase 'to maximise shareholder wealth'. He argues that it is impossible to put together all shareholders as if they were a homogenous group because each shareholder has different ideas regarding their investment. He thus identifies three shareholder groups: investors, speculators and owners. According to Yoshimori (2004), investors and speculators basically act identically with the objective of making profit from buying and selling their shares frequently and therefore they do not show interest in investing in the firm's long term benefit and its future course of events. In contrast to investors and speculators, owners are interested in the long term growth and market share of the firm. The different objectives of the various shareholder groups thus cause a problem in today's context where shares of large firms are widely dispersed with the majority of shareholders being either investors or speculators.[7] He further argues that short-term investors can easily diversify their investment and also exit by selling their shares so as to avoid risk. For the management and the employees of a firm, however, dispersing risk is not as easy as

[7] Tirole (2001, p. 2) points out that '80 percent of the trading of shares is done by institutions, which hold them for an average of 1.9 years'.

it is for investors. According to Yoshimori (2004) there is little reason to consider shareholders as the central stakeholder based on the argumentation that they are the only risk bearers.

Reflecting an agency theory perspective researchers and policy makers have offered various delineations of corporate governance. In the following two delineations of corporate governance that reflect an agency theory perspective are provided as illustrations.

Sheifer and Vishney (1997) explain:

> Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Sheifer and Vishny, 1997, pp.737).

Denis (2001) in his delineation of corporate governance refers to the agency problem, which is a central concern of agency theory:

> Corporate governance, then, encompasses the set of institutional and market mechanisms that induce self-interested managers (the controllers) to maximize the value of residual cash flows of the firm on behalf of its shareholders (the owners) (Denis, 2001, pp.192).

The above delineations of corporate governance are limited in that their focus is the basic agency relationship between shareholders as the owners of the company and management as their agent. Related to this is the assumption that shareholder wealth maximisation not only benefits shareholders but society as a whole. The narrow focus of the agency theory perspective of corporate governance has been understood by some to fail to address the wider impact of companies on a whole range of other stakeholders in addition to shareholders. The narrow focus of the agency theory perspective of corporate governance has come under criticism from researchers and policy makers influenced and guided by the ideas of stakeholder theory. In the following a brief overview of the emergence and characteristics of stakeholder theory and a stakeholder perspective on corporate governance are outlined.

2.2.2. Stakeholder Theory and Corporate Governance

The development of stakeholder theory in the sense of at least the use of the construct is credited to Edward Freeman's seminal book *Management: A Stakeholder Approach* (1984) (Näsi, 1995, Carroll and Näsi, 1997). The substance of a stakeholder approach has a longer history as one might reasonably suppose. According to Imanishi (2003), for example, the idea and concept of stakeholder, however, had already been proposed by the *Stanford Research Institute* (SRI) in 1963. They had defined stakeholders as: '[T]hose groups without whose support the organization would cease to exist' (Freeman 1984, p.31, quoted in Turnbull, 2007, p.183). Building upon and reflecting this definition, a wider and more extended definition of stakeholder can be developed:

> 'A stakeholder, then, is an individual or group that asserts to have one or more of the kinds of stakes in business. Just as stakeholders may be affected by the actions decisions, policies, or practices of the business firm, these stakeholders also may affect the organization's actions, decisions, policies or practices. With stakeholders, therefore, there is a potential two-

> way interaction or exchange of influence.' (Carroll, quoted in Näsi, 1995, p.22)

The term stakeholder, according to those supporting this kind of argumentation, includes '[o]wners, management, employees, customers, suppliers, government, community, media, unions, consumer groups and environmental groups' (Näsi, 1995, p. 22).

Freeman and McVea (2001) explain that the *Stanford Research Institute's* view is aimed at companies attempting to succeed in a long term perspective. In order to achieve long term success, managers have to be aware of stakeholders' interests and secure broad support from all stakeholders. Although the *Stanford Research Institute* initially defined the term stakeholder and other researchers further advanced the concept, Imanishi (2003, p.69) holds that it is reasonable to argue that the stakeholder approach in the context of corporations had not been very comprehensively developed until Freeman's seminal work.

A stakeholder approach or, as commonly referred to in the accounting[8] and corporate governance literature, stakeholder theory developed out of a critique of agency theory. The main point of the critique of agency theory that stakeholder theory responds to is the narrowness of focus of agency theory. While managers according to agency theory are required to only maximise shareholders' wealth in agency, stakeholder theory in contrast requires managers to adopt a wider view

[8] For an overview of the application of stakeholder theory in accounting see Alam (2006).

point, which takes into account a whole variety of stakeholders that are affected by or engage with the business organisation. According to Freeman and McVea (2001), the central task of managers from the perspective of stakeholder theory is to take into account the various interests of all participants and to develop relationships with them. They comment that existing strategies employed by management (and reflecting agency theory) ignore a whole range of stakeholders. Freeman and McVea (2001) make the point that those strategies will function under a stable business environment, however, under unstable conditions they will show limitations. They then put forward a proposal for a stakeholder approach as an alternative to a shareholder approach and indicate that it has some conspicuous features. A Stakeholder approach serves 'strategic management' to help decide the future course of a company: in the process of that management has to take account of the environment within which it operates. This approach also helps the company to survive, a crucial aim, because the manager is required to know its stakeholders who affect the company and are affected by the company, and to secure support from them so as to change the direction of the company. The stakeholder approach as elaborated in this context and typically in the literature does not seek to be driven by maximising shareholder's wealth. What is recognised is that it is vital for the manager to be acquainted with the stakeholders and gain their support in order to survive. This approach aims at long term success. If all stakeholders hold values in common it is possible that they may be coordinated via a stakeholder approach (Freeman and Mcvea, 2001).

According to Keasey et al (2005), the essence of stakeholder theory is that stakeholder theory attempts to broaden the scope of the related parties that have mutual relationships with the company and to satisfy all of them, whereas shareholder theory limits the extent to only maximize shareholder's wealth. Agency theory assumes that the shareholders risk their investment and face the possibility of no 'residual value' and shareholders, therefore, have priority over other stakeholders (Freeman and McVea, 2001, p.197). This is even if one might argue that those bearing the greatest risk are the employees whose livelihood depends on the firm: and while shareholders can dissolve the relationship (contract) with the management by selling their shares through a 'more liquid market, other stakeholders face a less liquid market (*ibid.*).

Many recent research studies have focused on the stakeholder approach (Donaldson and Preston, 1995; Carroll and Näsi, 1997). It has become a dominant or key theory for both in academics and professionals. (Donaldson and Preston, 1995; Carroll and Näsi, 1997). Mallin (2004), however, states that '[T]he definition of a stakeholder is much less clear and along with this lack of clarity comes an opaqueness regarding the role of stakeholders and the protection of their rights' (Mallin, 2004, p.44).

The scope of and gravity given to stakeholders highly depends on countries in which the companies operate. Letza et al. (2004, p. 205) refer to Donaldson and Preston's 1995 categorisation of stakeholder theory, which identified the following three types of stakeholder theory: 'normative, instrumental, and descriptive'. Of the three types of stakeholder theory the normative and instrumental type are the main types employed in research (*ibid.*). 'Normative' study regards the company as an 'end' because of the outcome of separation of ownership and control. No single investor can own and control a company and that makes it an independent entity with great influence on the community. This approach views a corporation as a single independent social entity that has a legal personality with its purpose and obligations rather than viewing the corporation as a group of persons, and therefore the manager is here liable for pursuing all company stakeholders' welfare (Letza et al., 2004). Characteristic of the 'normative' approach is that it is based on moral issues. This differs from the 'instrumental' approach, which views stakeholders as 'means' so as to ensure that the company achieves its objective. Stakeholder theory takes various related parties stated above such as shareholders, employees, customers, suppliers, government, community, unions into consideration and attempts to pursue not only the maximization of shareholder's wealth, but also satisfying stakeholders' interests.

There is criticism that stakeholder theory does not offer a developed theory of the firm. In this respect Learmount (2004, p. 12) has argued that 'the development of a rigorous and useful "Stakeholder Theory" of the firm still seems a long way off. And he makes the point that '[m]ost work in this field continues to be preoccupied with justifying a stakeholder approach to the firm, rather than the construction of systematic theory to describe more adequately contemporary organizational practices' (Learmount, 2004, p.12). A major limitation of many attempts to develop a stakeholder theory according to Learmount (*ibid.*) is their heavy reliance on economic theorising. He refers to Jones (1995) as an example of an attempt to combine stakeholder thinking with aspects of economic theorising, such as contractual situations, in order to achieve a reduction in transaction costs. Learmount (2004, p. 12) points out that Jones (1995) suggested an 'instrumental theory of stakeholder management' as he was concerned about the significant absence of testable theory in the stakeholder approach. Further, Jones (1995) stated that agency theory focused on reducing the conflicts between managers and shareholders by applying technical means such as monitoring systems and incentives schemes. Introducing stakeholder thinking into this situation therefore would help to reduce conflict as moral codes can reduce opportunistic behaviour and thus conflict. Such an approach would be more effective than just relying on technical means. Learmount (2004, pp. 12-13) is critical of Jones' argumentation as it is embedded in economic theory and works with the assumption that moral codes function well in the business realm.

Although there are some flaws to stakeholder theory it has become the dominant theory among academics and professionals. According to Clark (2005) even in the U.S., which is seen as the major embracer of agency theory, stakeholders are given considerable emphasis in this context. He also states that some countries such as Japan, as well as Germany, that are regarded as more stakeholder approach oriented, are taking shareholder's wealth into account much more than before. The developments globally indicate that although countries have different governance systems that reflect their particular cultures and histories they seem to adopt aspects of corporate governance systems from other countries. In light of these developments Clark (2005, p. 189) comments that 'a likely outcome is increased diversity within an overall trend towards convergence'.

Reflecting a stakeholder theory perspective various definitions of corporate governance have been offered. In the following two delineations of corporate governance that reflect a stakeholder theory perspective are provided as illustrations.

Aguilera and Jackson (2003) explain in referring to Aoki (2000):

> Corporate governance concerns "the structure of rights and responsibilities among the parties with a stake in the firm" (Aoki, 2000, p. 11 quoted in Aguilera and Jackson, 2003, p. 447).

Aoki (2008) further elaborates:

> We can then identify a firm's corporate governance mechanism with a set of rules (formal or informal) that regulate the action choices of the stakeholders contingent on the value stake of the firm. In particular, the crux of such a mechanism may be in the manager's behavioral beliefs regarding the plausible strategic reactions of other parties in the depressed corporate-value state. Such beliefs would in turn constrain and discipline his or her action choices *ex ante*... (Aoki, 2008, p. 435).

The above discussion of stakeholder theory has indicated that there are a variety of approaches in the literature, which point to the need of management to be accountable and to pursue the objectives of a whole range of stakeholders rather than just privilege shareholders as the only stakeholder group that matters. The various stakeholder approaches to corporate governance, however, differ in terms of the emphases they put on the various stakeholder groups. Although stakeholder theory goes in an important way beyond agency theory by acknowledging a whole variety of stakeholders, as typically presented in the literature, it still has significant limitations when viewed from the critical theoretical perspective outlined earlier in this chapter. The key limitations are: a lack of recognition that corporate governance is an embedded social practice; a limited consideration of the unequal power relations between the various stakeholders; and, a neglect of issues of change and strategy and the emancipatory/enabling potential of corporate governance practices. Without a thorough appreciation of context, to conceive of a stakeholder approach may be close to an empty endeavour. Indeed, since a shareholder approach also has to give some attention to stakeholders (it is a condition of profit making or wealth production that an entity at least survives, for instance), any distinction between the stakeholder and shareholder approaches will blur towards the point of rendering the distinction without meaning. Only when a thorough understanding of context is arrived at is it possible to begin to assess the significance of a mode of corporate governance in its particularities including the significance of its orientation to either a shareholder or stakeholder approach. Moreover, in accordance with this perspective, the better understanding is a critical one. For instance, from a critical perspective an organisation`s survival is not an adequate indicator of its social worth. This may be explained by structural and ideological problematics, for instance. And critical theory mobilised here attempts a subtle appreciation of other ambiguities and dynamics. The precise consequences and character of a given mode of governance are complex. They may not be summarised by alluding to notions of 'shareholder' and 'stakeholder' approach alone. One may here think of many actual and possible stakeholder approaches that also change over time. Below an attempt is made to delineate corporate governance from the critical theoretical perspective outlined above and to show its implications for an analysis of corporate governance in Japan.

2.2.3. Critical Theory and Corporate Governance

Critical Theory reminds us that social phenomena are embedded in a socio-economic, political and cultural context. An analysis of corporate governance has to thus carefully consider the characteristics of the context in which corporate governance is embedded. A key feature of the current context is globalisation, which has significantly impacted upon the way in which businesses – and organisations more generally – are governed. A critical theoretical perspective on corporate governance aims to gain insights into how global developments in the area of corporate governance impact upon and constitute threats and opportunities for local (as well as global) practices. For the study of corporate governance in Japan this implies an understanding of the Japanese system of corporate governance and also of the corporate governance system, currently gaining dominance globally. This may then form the basis for an assessment of how the push for a global corporate governance system (i.e. the push for convergence of national corporate governance systems with the emerging global system) impacts upon the national Japanese corporate governance system and engenders threats and opportunities. The assessment of the impact needs to consider the threats to what are perceived local particularities of the Japanese corporate governance system. At the same time this also implies a critique of the current Japanese corporate governance system and a consideration of opportunities arising in the context of global challenges to address aspects that might be improved in the Japanese system. There are related threats and opportunities from a global perspective.

A critical theoretical approach would especially be concerned to understand how national contextual characteristics have impacted upon and shaped Japanese corporate governance practices and how in turn Japanese corporate governance practices can reinforce or threaten national contextual characteristics. The cultural, the political and the socio-economic dimensions of context are of importance here. In analysis one has to be aware of the pitfalls of ethnocentrism, that is, an attempt has to be made to avoid viewing and assessing the Japanese corporate governance system from the perspective of the corporate governance system of one's own country.[9] At the same time, an attempt has to also be made to understand the Japanese corporate governance system without viewing it through the lens of the

[9] Ethnocentrism, of course, is not a problem if one analyses the corporate governance system of one's own country. In this case, however, there is the danger of another form of distorted view: one might see the practices of one's own culture through rose-tinted spectacles and idealise rather than critically appreciate these practices. The countering of this is at least an emphasis of the critical theoretical approach.

globally dominant corporate governance system, which is the Anglo-American corporate governance system.[10] In other words, one has to avoid the pitfalls of Westerncentrism.

Understanding corporate governance practises in their context also means understanding how they developed in interaction with their context. The study of corporate governance in Japan thus has to also include an historical account of how the particular Japanese corporate governance system has emerged. Such an account of the development of corporate governance will facilitate insights into the factors at play in the emergence and change of the particular Japanese corporate governance system. Such an understanding can contribute to a better understanding of current tensions within the system and between the Japanese corporate governance system and the emerging global corporate governance system.

An important aspect of Critical Theory is its concern with unequal power structures, which impact on what, for example, a person, a group of people or a nation state can and cannot do. In the context of corporate governance that means recognising that, for instance, stakeholders have not equal power and that this might lead to the privileging of certain stakeholder groups that are more powerful. This neglect of the interest of particular stakeholder groups might significantly impact upon their well-being or well-being more generally. In an analysis of Japanese corporate

[10] Gallhofer and Haslam (2007) have argued for the case of International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) that they reflect the Anglo-American tradition. The same argument can be made for the emerging corporate governance practice.

governance one therefore has to carefully consider the various stakeholder groups and identify to what extent their interests are addressed in the Japanese corporate governance system. Similarly, there needs to be a consideration of how changes to the system might threaten the interests and well-being of stakeholder groups. Further, the analysis also has to explore the extent to which Japan, as a nation state, is itself in unequal power relations with other nation states and the significance of this for the Japanese corporate governance system.

A key focus of Critical Theory is emancipatory change and relatedly the emancipatory/enabling potentialities of social practices. An analysis of corporate governance has to therefore explore possibilities for emancipatory change of national governance systems (and beyond) and the way in which corporate governance might be usefully mobilised to engender and facilitate emancipation. One has to aim to gain insights into the emancipatory/enabling potential of the Japanese corporate governance system. And of particular interest in the global context is an exploration of how aspects of the Japanese corporate governance system might be usefully employed in improving the global Anglo-American system with a view of enhancing well-being globally.

Based on the above theoretical elaboration for this study an understanding of corporate governance would be as follows: Corporate governance as a holistic construct encompasses all the influences on organisational processes organising the production and distribution of goods and services. It includes focusing on the processes involved in arriving at regulations and frameworks that impact on the design and implementation of corporate governance systems at the level of particular organisations. Corporate governance should properly serve the public interest and thus well-being, unrestrained as far as possible by convention or dominant understandings. In practice its functioning and consequences reflect (and indeed help constitute) the problematic context. But it is also ambiguous and embracing of more positive potential.

2.3. SUMMARY

Chapter 2 has provided a brief overview of the main characteristics of the critical theoretical perspective mobilised in this study. It has also offered a delineation of a critical theoretical perspective of corporate governance. This perspective was developed out of an appreciation of what are ostensibly the main perspectives in corporate governance research and policy debate, namely, the agency theory perspective of corporate governance and the stakeholder theory perspective on corporate governance. The next chapter, chapter 3, provides a critique of the literature on corporate governance in Japan and is informed by the critical theoretical perspective outlined in this chapter.

CHAPTER 3

A CRITICAL REVIEW OF THE LITERATURE ON CORPORATE GOVERNANCE IN JAPAN

The growing interest in corporate governance in Japan especially over the last two decades is also reflected in the academic literature. There is now a significant body of literature in the English and Japanese languages that summarises, explores and comments upon the Japanese corporate governance system and the challenges this system has been facing since the late 1980s. Given the interdisciplinary character of corporate governance, the contributions to the literature come from a variety of disciplines, including, accounting and finance, economics, management, human resource management, law, politics, sociology, international relations and Japan Studies. Although these studies approach corporate governance in Japan from their own perspectives and emphases they all provide interesting insights into and contribute to a holistic understanding of the corporate governance system of Japan, its development, the challenges it faces today and the corporate system and the wider context it is embedded in. The review of the literature identifies key trends, themes and assessments and critically reflects on the shortcomings of research to date.[11] It thus helps to show the contribution of this PhD thesis and also provides insights into key issues of concern and contextual developments which will inform the analysis of the empirics. The emphasis in the review here is on the literature

[11] Given the vast number of papers and books focusing on corporate governance in Japan and the constraints of a PhD thesis, the review of the literature highlights the main issues addressed and provides illustrations of contributions and their insights.

what focuses upon the period of the late 1980s to 2007, which is the period focused upon in this PhD. In discussing the literature a distinction is made between the literature in the English language and that in the Japanese language. Such categorisation helps to highlight differences and similarities between the English and the Japanese literature. This is of particular interest as it can facilitate insights into two types of academic discourse about the Japanese corporate governance system and the challenges it faced during the period from the late 1980s to 2007: one discourse in Japanese and thus inside of Japan, that is, a perspective especially for those inside and for those few who can access the inside via command of the Japanese language; and, another discourse in English and thus outside of Japan, that is, a perspective reflecting the perceptions of those looking into Japan from the outside.[12] Based on the overview and discussion of the literature the chapter then outlines the contribution of this PhD thesis. The structure of the chapter is as follows: a summary of the themes and issues addressed in the literature; a critical elaboration upon the insights of and gaps in the literature; and, an elaboration of the contribution of this PhD thesis to the literature.

[12] It is recognised that like any categorisation this categorisation has its problematic side: it can set up boundaries where there is fuzziness and overlap and create a sense of unity where there is diversity and difference. A particular case here would be the very few instances where a text was written in English by a Japanese researcher working in Japan. It is, however, reasonable to argue that if one is aware of such limitations a discussion of the literature according to this categorisation is helpful in attempts to identify general trends in the literature on corporate governance in Japan during the period of the late 1980s to 2007.

3.1. THEMES AND ISSUES ADDRESSED IN THE LITERATURE ON CORPORATE GOVERNANCE IN JAPAN

This section of the chapter provides a general overview of the main trends and themes and issues addressed in the English and Japanese literatures and a discussion of their similarities and differences.

3.1.1. The English Literature on Corporate Governance in Japan

Two broad groups may be identified in the English literature on corporate governance in Japan: first, papers and books that provide a general overview of the Japanese corporate governance system and the various changes to this systems during the period from the late 1980s to 2007, and, second, papers and books that focus on particular aspects of the Japanese corporate governance system during this period. The contributions in both groups are concerned to explore how contextual changes have impacted upon and changed the Japanese corporate governance system. Some, if not all, contributions also offer an assessment of the direction of change of the Japanese corporate governance system. Below, this literature is discussed in more detail.

Contributions to the English literature that aim to provide a general overview of the characteristics of the Japanese corporate governance system and its development over the last two decades highlight how specific characteristics of the Japanese corporate system have shaped the Japanese corporate governance system. This is a tendency that Luo (2005, p. 19) has identified for international corporate governance and accountability research more generally:

> International corporate governance and accountability research whether from a political science, economics, finance, or accounting perspective, has thus far predominantly focused on the comparison of corporate governance schemes in different countries and on the investigation of institutional parameters that determine these schemes.

Learmount (2004), for example, offers a detailed analysis of the corporate structures and practices of fourteen Japanese companies. The author's objective is to gain insights into what can be learnt from these practices. In case studies he focuses on the main characteristics of the Japanese corporate system, such as the role of shareholders, the company-main bank relationship, the role of the employees and the role of the Japanese directors as key determinants of the Japanese corporate governance system. He also points to the relevance of an understanding of the context in which the firms are operating. Yafeh (2000) studies the historical developments of Japanese corporate governance mechanisms in order to identify what has shaped today's Japanese corporate governance system. According to Yafeh, 'monitoring and intervention by large shareholders' and 'monitoring and intervention by creditors, typically banks' were two factors that played an important role in the development of Japanese corporate governance (Yafeh, 2000, p.75).

Books and papers more generally concerned with the Japanese corporate governance system have also aimed to show how changes in the socio-economic and political context since the late 1980s have impacted upon the Japanese corporate system and the Japanese corporate governance system. These studies have identified the strong impact of the Anglo-American corporate governance system in shaping the Japanese system (see below).

A key, if not the main, focus of the literature is the changes in the Japanese corporate governance system that may be observed since the 1980s. Researchers from various disciplines (including law, management, economics, finance, politics, human resource management, politics) and employing a variety of research approaches have aimed to document and assess these changes. The central question in these studies relates to convergence, that is, is the traditional stakeholder oriented model of Japanese corporate governance converging with the Anglo-American shareholder oriented model. Researchers have come to various conclusions. Some have interpreted the changes in the law, the structure of the board of directors and the increase in the number of independent directors as an indication that convergence is taking place and that it is only a matter of time until this process is completed. Jackson and Miyajima (2007) summarise developments in Japanese corporate governance since the early 1990s. They elaborate how 'well-known features of the Japanese firms, such as the main bank system, cross-shareholdings, boards dominated by insiders, and lifetime employment have undergone significant crises' (*ibid.* p. 1), which has resulted in changes in the system (see also Dore, 2005; Aoki, 2006; Yoshikawa and McGuire, 2008). They discuss these changes in the Japanese corporate governance system and argue that 'many changes suggest a step toward more market-oriented corporate governance as found in countries like the United States or Britain' (*ibid*). Aoki (2006) analyses how changes in the context in which Japanese corporate governance is located have shaped corporate governance in Japan. He especially points to changes in the political arena (change of government) and the economic sphere (the end of the bubble economy). Given the contextual challenges, Japanese firms have changed their corporate governance structures, which Aoki (2006, p. 3) interprets 'as a possible transition from the traditional bank-oriented [Japanese] model to a hybrid model'. Dore (2005, p. 441), in a comparative study of Japan and Germany, argues that 'pressures in both Japan and Germany for revamping of the corporate systems along Anglo-Saxon lines have been intense in recent years'. He states that this is the result of internationalization and 'steady convergence of Japanese elites on American value' and 'half a century exposure to US cultural dominance' (*ibid*, p.441). Others have highlighted continuity as well as change and are less certain that convergence with the Anglo-American model will occur. Yoshikawa and McGuire (2008), for example, in their paper 'Change and Continuity in Japanese Corporate Governance' also focus on recent changes in the context and their effect on corporate governance. They identify continuity as well as change in Japanese corporate governance and urge researchers to take into account 'unique institutional arrangements' (*ibid.*, p. 5) in analyses of the changes of the Japanese corporate governance system. Jackson (2005) refers to German and Japanese labour management practice and their participation by way of example of typical countries where stakeholder-oriented corporate governance is dominant. The author acknowledges that there is a pressure in these countries for convergence toward the market-oriented model and insists that Germany and Japan should cope with this phenomenon. He concludes that convergence towards a single model seems to be a global trend; however, as 'convergence on a single model remains far away', Germany and Japan can modify their employment system and prepare for changing circumstance.

Within the contributions to the English literature that constitute group two for the purposes of this literature review and that focus on particular issues and themes in relation to corporate governance, several key focuses can be identified: corporate performance; executive compensation; the board of directors; the banks as providers of capital; ownership structure; accounting disclosure; Japanese style employment practices; and, change and convergence. This literature also aims to explore specific changes related to aspects of the Japanese corporate governance system in the context of changes in the corporate system and wider contextual changes.

Several studies in the English literature focus on the interrelationship between corporate governance and corporate performance. Watanabe and Yamamoto (1993) in an early study on the interrelationship between corporate governance and the performance of Japanese firms argued that the Japanese corporate governance system had not adequately adjusted to contextual changes of the 1980s and that the 'current economic recession gripping the country can be called a "governance recession"' (*ibid.*, p. 208). In considering how the low profitability of Japanese companies might be improved they explore the advantages and disadvantages of implementing characteristics of the US corporate governance system in Japan. They point out that 'ultimately, perhaps the most important element of corporate governance is how society at large assesses corporate performance' (ibid., p. 225). This in the end will have a significant impact on how managers deal with the performance of their companies. Yoshimori (2005) compared the performance of Toyota and Canon with that of GM and Xerox. He finds that the performance of Toyota and Canon is better than that of their competitors. He thus concludes that 'higher performance is possible without resorting to US-style corporate governace…[as]…corporate values, culture and strategy are equally vital ingredients of corporate success' (ibid., p. 447). Bauer et al. (2008) based on a data set provided by Governance Metrics International explore if Japanese firms with many corporate governance provisions achieved a better performance and what types of provisions where most significant. Their results indicate that firms, which are well-governed show better performance and that remuneration, financial disclosure and shareholder rights positively effected share prices. Colpan et al. (2007) explored the impact of changes in corporate governance that had taken place on a corporate as well as institutional level on corporate performance. They observe that 'shifts in terms of stock ownership, corporate control and managerial organizations' (*ibid.*, p. S89). Their insights in terms of the impact of changed ownership composition and changes in the corporate governance system were inconclusive in terms of their impact on corporate performance. The authors thus conclude that their 'findings validate the current transitional state of Japanese corporate governance, where some firms are trying to adopt new practices in form only or with modifications to suit local and firm-specific context, may bring unintended performance consequences from what such practices were originally designed for (*ibid.*, p. 110).

Researchers exploring the relationship between executive compensation and company performance have arrived at a variety of insights. Basu et al. (2007) in their study of 174 large Japanese companies during 1992-1996 found that 'excess pay related to ownership and monitoring variables is negatively associated with subsequent accounting performance', which they identify as being consistent with an agency problem. Interestingly, their results did not show 'an association between excess pay and subsequent stock returns' (*ibid.*, p. 56). Kato et al's (2005) study of about 350 companies, which had employed stock options as part of executive remuneration between 1997 and 2001, finds evidence of an improved operating performance of these companies. They thus conclude that 'well-designed incentive compensation plans are consistent with the creation of shareholder value' (*ibid.*, p. 436). Kubo (2005) analysed the effect of pay policy on the performance of Japanese companies and found that companies with high performance-pay sensitivity to not show higher performance. Ferris et al. (2007) investigated the relationship between weak corporate governance and managers' ability to design executive compensation that is advantageous to them. They found that strong corporate governance, especially small board size and high percentage of independent directors, are important mechanism of control that influence management in the design of stock-option compensation schemes.

Papers focusing on the board of directors have explored the interrelationship between the size and composition of the board of directors of Japanese companies and corporate governance. The emphasis in these studies is on firm performance and the protection of shareholder interests. Early studies (Viner, 1993; Kaplan and Minton, 1994; Davis, 1996) especially highlight the differences between the Japanese board of directors and the American board of directors. Viner (1993, p. 112), for instance, argues that the interests of shareholders of American public corporations are well protected as 'independent outside directors today constitute the majority of board members at major American public corporations'. He contrasts this with the situation of shareholders of Japanese public corporations in arguing that 'outside shareholders' considerations such as dividend payout and share price are of no more relevance to Japanese boards than the weather in Antarctica' (*ibid.*, p. 113). The study by Kaplan and Minton (1994), which explored factors determining the appointment of outsiders to the boards of directors of Japanese companies, found that in the context of poor performance former employees from banks were appointed. They conclude that in contrast to the U.S. 'banks and corporate shareholders play an important monitoring and disciplinary role in Japan' (*ibid.*, p. 227). Later studies, reflecting changes in Japanese law that allowed companies to either follow Japanese style corporate governance or American style corporate governance, focused on changes in the composition of the board of directors. Wailerdsak and Suehiro (2004) found that despite the discourse of a change in composition of the board of directors 'the ratio of internally promoted directors and executives remains high' (*ibid.*, p. 85). Papers investigating the relationship between board composition and performance of Japanese companies come to inconclusive results. Bonn et al. (2004), for example, found that board size and age of directors had no impact on the performance of the firm. In contrast, Bebenroth and Donghao (2007) found that Japanese companies who had adopted a US-style committee structure showed the best performance. Gilson and Milhaupt (2004) who investigated the extent to which companies switched from the Japanese style board structure to the U.S. style and the impact of this on their share price found no significant share price changes. Similarly, the empirical evidence in the Yoshikawa and Phan (2003) study suggested that 'the increase in the ratio of outside directors, the separation of the board members and executive officers, and the reduction of borad size were not related to firm performance' (*ibid.*, p. 698). The study of Aoki (2004), which investigated the effect of the introduction of the executive officer system on firm performance, did not find any positive correlation. Masui and Kakabadse (2002) discuss the adopting of the officer system by Japanese companies from the perspective of improving management. They argue that introducing an officer system will not improve the way companies are managed as the aim of the introduction of the officer system is to reduce costs through avoiding the risks arising from lawsuits by shareholders.

Corporate governance issues in the context of Japanese banks have attracted the interest of researchers from several disciplines but especially from those in the areas of finance, financial economics and economics. Studies have broadly focused on two areas; first, the role of Japanese banks in the corporate governance systems of Japanese firms and, second, the corporate governance systems of Japanese banks themselves. The main emphasis in research was initially on the former as the key role of Japanese banks as providers of capital with its associated monitoring function significantly differed from that of Anglo-American banks. Studies have explored the development of the Japanese banking system and highlighted the important monitoring role of Japanese banks. Sheard's (1989) analysis of the Japanese main bank system, for instance, argued that the close relationship between company and main bank acted as a substitute for the '"missing" takeover market in Japan' (*ibid.*, p. 399). Based on their analysis of a sample of Japanese firms, Morck and Nakamura (1999) found that the monitoring role of the banks does not constitute a form of governance that is concerned with shareholder wealth maximisation as banks also may act in the interests of a broader range of stakeholders. Nakamura (2002) investigated whether the increase in public debt issuances in the context of the recent crisis of the banking sector has led to a decrease in the corporate governance role of banks. His empirical results suggest that Japanese banks still seem to play an important corporate governance role. More recently, and in the context of the Japanese banking crisis, researchers have begun to explore the corporate governance systems and practices of the banks themselves. The main focus here was on the effectiveness of the corporate governance system of Japanese banks (Hanazaki and Horiuchi, 2000). Hanazaki and Horiuchi (2003) point to the difficulty of monitoring banks in the context of relationship banking. They argue that the inability of outsiders, such as the capital market and the government, to exercise control and restrict imprudent bank management played a significant role in the banking crisis. Hossain (2005) also suggests that the weaknesses of the Japanese corporate governance crisis are the key factor in explaining the banking crisis. Similarly, Dinc (2006) points to the inability of shareholders to discipline bank managers in the context of cross-shareholdings and relationship banking. Anderson and Campbell (2000) in a study of internal and external corporate governance at Japanese banks found that before as well as after the banking crisis of the 1990s external governance (for example, mergers) appeared to be inactive whereas internal governance especially after the beginning of the banking crisis appeared to be especially active (for example, non-routine turnover of bank presidents). In contrast to the above studies, which employed an agency theory perspective in their analyses, Wan et al. (2005) adopted a social exchange perspective in their analysis of the Japanese banking system and restructuring attempts within the sector. They hold that although economic factors are important in understanding corporate governance and corporate restructuring a consideration of the social embeddedness of corporate governance practices provides a better understanding of the processes at work.

The ownership structure of Japanese companies and changes to it has been another focus in the English literature. Research reflecting an agency theory perspective has investigated the relationship between ownership structure and firm performance. Prowse (1992) found that ownership concentration of firms who are members of a corporate group (*keiretsu)* does not lead to higher returns whereas it does in the context of independent firms where shareholders exercise more control over management. The study by Lichtenberg and Pushner (1994) showed that equity ownership by banks acted as a control mechanism and thus positively affected firm performance. This contrasts with firms with a high level of intercompany shareholding, which 'insulate[s] firms from their own problems, at the expense of firm performance' (*ibid.*, p. 239). Hu and Izumida (2008) also report that corporate performance is significantly affected by ownership concentration. Seki (2005) elaborates upon recent changes in ownership of Japanese companies and the law. These changes have led to increased shareholder activism, especially by foreign institutional investors and thus increased the awareness of managers of corporate governance issues. Suto and Toshino (2005) in a study based on a questionnaire survey found that the corporate governance role of Japanese institutional investors is limited because of the short-time bias of fund managers to represent themselves in the best light for marketing purposes. Suto and Toshino (2005, p. 466) thus conclude that 'institutional investors' behaviour thus contradicts their role as shareholders'.

It is somewhat surprising that little research has been done that analyses accounting as an important component of the corporate governance system in Japan.[13] Although there are studies, which provide a historical perspective on the development of financial accounting in Japan, the recent changes in the legal framework for accounting and the adoption of *International Accounting Standards* (IASs) and *International Financial Reporting Standards* (IFRSs) they do not link such developments to wider concerns about corporate governance. An exception is the book by Demise et al. (2006), which offers a discussion of corporate governance in Japan from the viewpoints of management, accounting and the market. The chapter on "Accounting and Disclosure in Japan" by Nakoshi (2006) offers a brief description of the disclosure in Japan that is related to corporate governance, for example, the requirements of the Tokyo Stock Exchange. She also indicates that there is demand from shareholders for accounting disclosure but that many firms are reluctant to provide this information.

Another significant focus of the English literature is the interrelationship between Japanese style employment practices and corporate governance. Abe (2002) explores the impact of Japanese corporate governance structures on the employment practices of Japanese firms. Based on financial data for companies listed on the Japanese stock markets he focuses on the interrelationship between the rate of employment and adjustment and corporate governance structure in place. He concludes that the speed of employment adjustment in Japanese firms is directly

[13] In this chapter only the literature that specifically and explicitly focuses on accounting disclosure in the context of corporate governance is discussed.

linked to characteristics of the Japanese corporate governance system. These characteristics are cross shareholdings and existence of large shareholders. Abe and Shimizutani (2007) examine the interrelationship between Japanese style employment practice and corporate governance structure in the context of recent significant changes in the ownership structures of companies and the composition of the board of directors. The paper shows that decisions to reduce labour costs depend on inside and outside directors. Outside directors tend to prefer layoffs and voluntary or early retirement schemes whereas inside directors prefer not to take new employees and protect existing employees. Buchanan (2007) offers an outline of a dimension of Japanese corporate governance structure as 'internalism': the members of the board of directors are appointed by internally promoted former employees. He finds that many managers in large Japanese companies do not seem willing to have external members on the board of directors as these external members do not have relevant knowledge of the company and therefore they doubt the efficacy of outside directors. Even if companies implemented external supervision they still largely maintain their internal management system. Jackson (2005) highlights 'how changes in corporate governance impact labour management, particularly in the countries with stakeholder-oriented corporate governance' (Jackson 2005, p. 419). The paper by Jacoby et al. (2005) investigates the differences between the role and positioning of HR executives in Japanese and US companies and the impact of this on corporate governance. The main insights from this study are that changes in the role of HR executives in both countries have taken place but at different pace. The US experienced quicker change than Japan and this in turn had a different impact on the corporate governance structures of both countries. In the US, where the finance function and a strong shareholder ethos dominate HR, executives are less likely to be prominent on the boards. In contrast, in Japan, where there is less of an emphasis on the finance function and the shareholder ethos, it is more likely for HR executives to be included on the board.

Having summarised the key issues focused upon in the English literature on corporate governance in Japan the next section offers a summary of the key issues focused upon in the Japanese literature. This is followed by a critical evaluation of both literatures.

3.1.2. The Japanese Literature on Corporate Governance in Japan

There is a large body of literature on corporate governance in Japan in the Japanese language that focuses on the period of this study. Similar to the English literature, the Japanese literature on corporate governance can also be divided into two groups: first, those works that offer a general discussion of issues facing corporate governance in Japan and the development of the Japanese corporate governance system, and second, those works that focus on specific corporate governance issues. The contributions to the literature in the Japanese language are especially concerned to assess the appropriateness of the changes proposed to the Japanese corporate governance system or those changes that have already been implemented. Below the main insights of this literature are discussed and summarised.

The papers of the first group, which provide a general overview of corporate governance issues in Japan, make an attempt to identify the key areas of concern. These papers also present attempts to explain the background to the corporate governance debate in Japan, that is, when and why corporate governance became a hotly debated issue in Japan. More specifically, papers aim to identify from various viewpoints the origins of the problem(s) facing the Japanese corporate governance system in the context of a changing environment (Itoh, 1994; Kawamura et al., 1994; Uetake, 1994; Demise, 1997; Koyama, 1998; Kagono, 1999; Hatta 2005; Hirata, 2002a, b). They also offer explications and analyses of the characteristics of the Japanese corporate system and an evaluation of the Japanese corporate governance system in this changing context (Ariakwa et al., 2006; Udagawa, 2000). There are two broad positions evident in the literature: first, the view that the traditional Japanese corporate governance system can appropriately deal with the changing environment and care should therefore be taken in replacing it with a corporate governance system from a different cultural and socio-economic context; and, second, the view that the Japanese corporate governance system is not appropriate anymore because of the significant changes globally and that it consequently needs to be changed. In addition, several papers make an attempt to assess the Japanese corporate governance system and to offer possible future models for Japanese corporate governance (Sakai, 2005; Sasaki, 2001; Sato, 2002). Illustration of the argumentation in these studies is provided below.

There is general agreement in the literature that corporate governance became an important issue during the 1990s in Japan. Hirata (2001) makes the point that although the issue of corporate governance has developed into a hotly discussed issue in the areas of accounting, economics, finance, law and securities globally, there were only six researchers in the area of business management in Japan who did research on corporate governance in the first half of the 1990s. This situation, however, changed dramatically in the latter half of the 1990s, as researchers in the business management area had been stimulated by the findings in the academic disciplines mentioned above. Hirata (2001) reviews the studies published by the six Japanese researchers as well as the activities of the Japanese government, the Liberal Democratic Party and the recommendations published by Japanese business organisations in order to assess current developments in the Japanese corporate governance system. Hirata (2001) points to an important difference in the reasons for the concerns with corporate governance in Western countries, such as, for example, the U.S, the UK and Germany, and Japan. Western countries, according to Hirata (2001), had already overcome the problem of corporate scandals in the early 1990s and the main concerns in these countries in terms of corporate governance had moved to a concern with the relationship between governance and business competitiveness. In contrast, corporate governance problems in Japan arose from frequent corporate scandals during the 1990s, and as a consequence the main focus in relation to governance in Japan was thus on the accountability of management rather than corporate performance. Hirata (2001) argues that there were eight areas that had a significant impact on the emergence of the corporate governance debate in Japan: unprotected shareholders' wealth resulting from the separation of ownership and control in modern large corporations; the necessity of coordinating the interests amongst various interest groups; recurring corporate scandals after the bubble economy had burst; weak performance of corporations in the post bubble economic context; awareness of shareholders of shareholder activism; simplification of derivative lawsuits; necessity of agile management of companies; and the need for efficient management of companies in the context of corporate globalisation. Hirata (2001) claims that the first three issues can be observed globally whereas the remaining five issues are unique to Japan (*ibid.*, p.82). Uetake (1994) argues that the rise of institutional shareholders was the key impetus for the growing corporate governance debate. The author further highlights that under recent economic growth and the advancement of globalisation, which has led to increased pressure for market liberalisation, Japan has also been urged to change its corporate governance system. Studies in the Japanese language have also attempted to describe the Japanese corporate governance and corporate system and to identify the key components of these systems. Itoh (1994), for example, in his general discussion of corporate governance, has pointed to key issues in the corporate governance debate as being the board of directors, including composition and size of the board; the monitoring system, such as, for example, the board of corporate auditors; and, accounting and disclosure. Relatedly, Saito (1994) in his study identified cross shareholding, lifelong employment, seniority based promotion, main bank system and industrial group (*keiretsu*) as the key components of the Japanese corporate system that significantly shape the Japanese corporate governance system.

Koyama (1998) illustrates that the recent transformation of the Japanese corporate governance system is the result of depressed corporate performance accompanied with the prolonged recession after the bubble economy had burst. He argues that the once praised Japanese corporate system has become an obstacle for change and makes the point that change is inevitable for Japanese companies. He further states that the number of foreign investors has become significant and that Japanese companies therefore have to justify their systems, including their corporate governance systems. Koyama (1998) makes the important point that these systems do not need to be the same as the corporate governance systems of foreign companies. He holds, however, that Japanese companies have failed to convince investors, including foreign investors, of the appropriateness of the Japanese system more generally and the corporate governance system more particularly. He reviews efforts of Japanese companies to design new Japanese management systems and practices and reaches the conclusion that it is difficult to establish better systems that are consistent with Japanese tradition and culture. Writing in 1998, he argues that although the reform of the Japanese corporate governance system has just started, this reform will significantly impact upon companies and decide their future prospects. Further, he urges Japanese companies not to confuse the American standard with a global standard when aiming to improve Japanese systems. Egawa (2003, 2005) focuses on the interrelationship between the current economic crisis and the specific characteristics of the Japanese corporate governance system and corporate system with a focus mainly on Japanese human resource management. He argues that the recession of the 1990s was not the problem of the particular management style and employment policies of Japanese companies but rather a decline of demand for Japanese products. Egawa thus positively supports Japanese employment practices such as lifelong employment and seniority based promotion and payment as they contribute to the development of Japanese economic growth. He explains that it has become fashionable to see the U.S. corporate governance system as an ideal mechanism for checking and controlling management in the context of a rapidly expanding globalisation. He, however, objects to introducing U.S. corporate governance systems to Japanese companies as U.S. systems only effectively work in the U.S. context, for which they have been designed. Sudo (2006) investigates the Japanese human resource management system and the Japanese corporate governance system, especially focusing on the lifelong employment system. He argues that Japanese capitalism differs from U.S capitalism. In Japan, the manufacturing sector is more important than the financial sector and it is thus essential for companies to protect their employees who have company specific knowledge and skills, which they have obtained through their work experience. He points out that Japanese corporate practices including the lifelong employment system, face changes because of the low economic growth after the bursting of the bubble economy. Sudo (2006) concludes that Japanese companies should design corporate governance systems, which are based on the customs and set of values rooted in Japanese culture and society. Okabe (2002) explores recent trends of corporate governance research in Japan and states that the area of corporate governance should not be considered only within one discipline as it is complex and relates to various disciplines, such as, for example, microeconomics, business management studies, accounting and law. He stresses that research on corporate governance in Japan should focus on ownership structure because of the unique ownership structure of Japanese companies, namely cross shareholding. He also makes the point that the rise of foreign and institutional investors and the reforms of Japanese employment practices may lead to a transformation of Japanese corporate governance systems. Further, he claims that in order to be able to propose relevant corporate governance systems for these countries researchers should consider each country's historical, social and cultural context.

Within the contributions to the Japanese literature that constitute group two for the purposes of this literature review and that focus on particular issues and themes in relation to corporate governance, several key focuses may be identified: the board of directors; executive compensation; the executive officer system; the banks as providers of capital; ownership structure; accounting disclosure; internal control; the law; management practices; accountability and ethics. This literature also aims to explore specific changes related to aspects of the Japanese corporate governance system in the context of changes in the corporate system and wider contextual changes.

Research on the board of directors and corporate governance has developed as a focus of the Japanese literature since the emergence of the debate in the early 1990s. Papers either provide general overviews of issues related to the board of directors' issues (Demise, 1997; Inabetsu, 2002) or focus on specific issues in detail, such as, for example, the composition of the board of directors, which often is discussed in relation to the introduction of non-executive directors (Shishido 2003, Miyauchi, 2003Book). Other related issues are the remuneration system for members of the board of directors (Sakai and Yun 2007, Yamazaki 2003), the role of the executive officer (Aoki 2002, Abe 2002, Sawaguchi 1999, Tanaka 2001, Niwa 1998, Yamaguchi 1999) and matters related to companies with a committee system (Takei, 2002, 2002; Morimoto 2003a, b, c; Yamada 2003).

Inabetsu (2002) argues that it is assumed that a corporation is supervised by the market and the board of directors. He makes the point, however, that the American experience during 1980s has shown that the market's role to maintain discipline may be questioned. Thus, in a context where market mechanisms cannot be relied upon the board of directors is expected to reinforce control. The board of directors therefore constitute an internal control mechanism through their monitoring function. He illustrates that the history of the reform of corporate governance is the history of the reform of strengthening the monitoring function of the board of directors. Inabetsu (2002) points out that the U.S. is perceived as having the most advanced monitoring function. Recent corporate scandals have, however, damaged its reputation. He reached the conclusion that the independence of the board of directors from management was the key to sound corporate governance. Only if the board of directors is independent can it perform its monitoring function. In order to perform its monitoring function as an agent of the shareholders obstacles have to be overcome (Inabetsu, 2002). Inabetsu (2002) identifies several obstacles, such as, for example, the dual role of the chief executive officer and board chairman, a gap of knowledge and unequal power relations between the CEO and board members, and issues related to the board of directors as they decide and approve a company's business strategy. In the context of the above issues, institutional investors play an important role in enhancing corporate governance. Finally, as many nonexecutive directors are other companies' executive managers or CEO, it is important to find ways of motivating them. In his study Demise (2002) argues that the reform of the board of directors has developed with the trend in Japan being the reduction of the number of members of the board of directors and an increase in the number of non-executive directors. He concludes that the board of directors provides a link between the owners of a company and its management and that there is therefore a possibility to send related party's representatives to the board of directors to balance their stake. Shishido (2003) remarked that historically the government aimed to improve corporate governance through amendments of the *Commercial Code*, which reinforced the auditing system. As these attempts had failed to establish the credibility of the Japanese corporate governance system, the government thus further amended the *Commercial Code* in 2003 and gave Japanese companies the option either set up the original Japanese board system with its board of corporate auditors or the U.S.-style corporate governance system with its board of directors and its various sub-committees. He argues that the external board of directors has traditionally been expected to exercise a monitoring function. In contrast, he views the board of directors as a place for negotiation between providers of capital and employees. Miyauchi (2003) in his paper claims that the objective of corporate governance is to maximise shareholder wealth under shareholder capitalism and points to the important function of non-executive directors as monitors of management.

The remuneration model for members of the board of directors has also been the subject of study of Japanese researchers. Sakai and Yun (2007), for example, argue that the compensation of Japanese companies' executives was monthly pay and retirement pay by the 1980s because the main banks had played a monitoring role as a creditor and thus had lowered agency costs. Under such circumstances, that is, low agency costs, there was less demand to link executive compensation with corporate performance. In addition to the monthly compensation the promotion system functioned as another kind of reward. The environment for Japanese companies, however, changed in the latter half of the 1980s because of deregulation and globalisation of the financial system. As a consequence of these developments the monitoring function of the banks has become less effective, which led to a rise in agency costs (*ibid*, pp.3-4). Based on their analysis, the authors therefore conclude that, under the new circumstances, executive pay should include stock options and plans should be designed based on a medium- and to long-term perspective. Peng (2003) argues that the introduction of share price interlocking systems such as stock options by Japanese companies has encouraged managers to maintain a high share price. He suggests that this could constitute a first step of a corporate governance reform. Further, he concludes that it is also important to disclose executives' pay schemes so as to improve the corporate governance system.

The introduction of the executive officer has also captured the attention of Japanese researchers. Aoki (2002) suggests that the introduction of executive officers may offer a solution to the main problems that Japanese companies' board of directors have, namely, inefficiency of the board due to its size and unification of the execution of duty and monitoring. Further, he suggests that low corporate performance, growth and capital efficiency all would trigger the introduction of executive officers. Yamaguchi (1999) points out that Japanese companies have entered a global era of mega competition. As shareholder wealth maximisation has become a primary corporate object, Japanese companies have thus moved away from traditional Japanese systems, including the Japanese corporate governance, and begun to converge with a global standard model so as to maintain their competitive edge. In this context he states that to introduce the corporate officers system is inevitable in order to achieve shareholder wealth maximisation. He observes, however, that this system has not yet been fully implemented in Japan and suggests that some of these problems might be resolved by enforcing related laws.

In research focusing on corporate governance and accounting, corporate governance issues are referred to in the context of issues relating to disclosure (Ishii, 2004; Hiramatsu 2001, Furusho, 1999; Matsuo, 2002; Mukoyama, 1999; Morita, 2005; Yamazaki, 2003), internal control (Fujikawa, 2003; Kakizaki, 2004; Suenaga and Fujikawa, 2004; Nishimura, 2005; Ichiko, 2007; Hatta, 2007; Iyoda, 2007), accountability of management (Demise, 1997a, b), International Accounting Standards (Itoh, 2003), and the reform of the accounting systems (Kakurai, 1999; Fujikawa, 2003; Matsumura, 2002). In the debate on accounting disclosure and corporate governance, for example, Takao (1999) explores corporate governance issues within the accounting framework. He argues that corporate governance can be investigated from the point of view of disclosure and reaches the conclusion that the accounting system itself takes on an important role as a control mechanism. Hiramatsu (2001) also focuses upon disclosure issues in his corporate governance research. He acknowledges that tough competition in the global market in conjunction with the intensification of globalisation and the long lasting economic slump and the successive emergence of corporate scandals, which were followed by the bursting of bubble economy, all led to an increasing debate over corporate governance in Japan. He explains that the current trend in the corporate governance reform is changing the corporate governance systems in line with the U.S. systems. The aim of this reform is to strengthen the authority of the auditor. Hiramatsu

(2001) also stresses the importance of including disclosure in the corporate governance reform.

Itoh (2003) makes the point that International Accounting Standards, especially fair value accounting, relate to corporate governance. He points out that the introduction of current value accounting put an end to the Japanese corporate governance system because Japanese companies were no longer able to maintain their practice of cross-shareholding, which is one of the main characteristics of the Japanese corporate system and significantly shapes the corporate governance system. He expresses the view that Japanese companies are apparently forced to change their traditional systems. This is, however, a problem as, according to Itoh (2003), the American system cannot be adopted into Japanese context. Instead it is important for Japanese companies to establish a new system, which enhances corporate value in such a way that it satisfies all participants of a company.

The papers that focus on internal control as an important component of the corporate governance system explore ways of setting up proper monitoring systems in Japanese companies. Ichiko (2007) argues that the *New Company Act* and the *Financial Products Exchange Law* both are enabling internal control systems. Both laws, however, are aimed at different aspects of the internal control system. The *New Company Act* covers the role of the board of directors and of corporate executives. A restriction of internal control in the *Financial Products Exchange Law* aims at ensuring reliability of financial reporting. Ichiko (2007) sees a contradiction between these two laws and argues that this might negatively impact on a company's objective, as stipulated in the law, of maximising shareholder wealth. He therefore suggests that the two laws should be reconsidered and adjusted.

Demise (1997) has argued in the context of writing about corporate governance and accountability that the application of authority must be accompanied by accountability so as to gain legitimacy. Viewed from this perspective he claims, however, that in Japanese companies, the board of directors and executives are not clearly separated and some shareholders are therefore calling for more accountability. Demise (1997) reached the conclusion that the debate over corporate governance in Japan changes the relationship between management and shareholders and leads to changes in the corporate structure of Japanese companies.

There are several papers written by law academics that focus on the interrelationship between Japanese legal requirements and corporate governance. The main focuses of these papers are changes in and developments of the *Commercial Code* and their impact upon the corporate governance structures of Japanese companies (Suzuki 1999; Suenaga 1999; Yoshida 2004; Miyajima 2000). Tabata (2005) remarks that recent corporate scandals and an indication of the lack of explicit monitoring systems have led Japanese companies to establish compliance systems. This phenomenon is the result of attempts to achieve efficiency and competitiveness of a company and an increase in the number of foreign shareholders, who have urged management to consider shareholder wealth. The author suggests that the OECD recommendation should be taken into consideration in reforming the laws and calls for further debates. Papers on corporate governance and the *Commercial Code* generally refer to the recent amendments of the *Commercial Code* (especially those in 1993, 2002 and 2003) (Yoshida, 2004). Papers focus upon the responsibilities of corporate executives and the board of directors and consider how the law has imposed higher responsibility on them in relation to corporate governance (Yoshida 2004). In his study Miyajima (2000) ascribes frequent revisions of the *Company Code* to the rapidly changing business environment especially outside of Japan in the context of globalisation. Although, he acknowledges that Japan cannot stand alone and therefore needs to adapt to changes in the global environment he at the same time questions if the law amendments should only contemplate external factors. Analysis shows that this series of law revisions has aimed at restoring and strengthening the right of shareholders and the annual meeting.

There are several papers in the Japanese literature that focus on the relationship between management and corporate governance (Demise, 1994; Sakum, 2000; Nakamura, 2003; Hirata, 2002b). Hirata (2002b) in his study points to the important role of management in the context of the successful operation of a company. He argues that the corporate governance system is one of many functions that help reduce corporate scandals and enhance corporate competitiveness. He holds that too much emphasis is placed on the corporate governance system and other important factors contributing to the avoidance of scandals and the enhancement of corporate competitiveness are overlooked. He concludes that even if companies have good corporate governance systems their progress still depends on whether they are managed properly by management. Hirata (2002b) therefore suggests that it is important not only to establish the hardware (that is, the corporate governance system) but also the software (that is, management). Similarly, Nakamura (2003) argues that the bursting of the bubble economy had provided an opportunity for Japanese companies to also re-think their corporate management systems. He further pointed out that under the intricate and complex socio-economic circumstances, it is not rational to only have shareholder wealth maximisation as the purpose of management. It is therefore important to expand the objectives that managers have to pursue and include multiple purposes that have to be simultaneously pursued. He also stressed that managers' behaviour is dependent on their personality, which in turn is based upon their cultural and social values.

There has also been an interest amongst Japanese academics to focus on accountability and ethics in the context of corporate governance. Demise (1998), for example, made the point that a key issue in the context of corporate governance is accountability because if management is conscious of accountability, this will impact positively on their behaviour. Despite the importance of instilling a sense of accountability the corporate governance reform in Japan has been advanced through revising related laws. Demise (1998) comes to the conclusion that self-imposed control by industrial organisations and corporate ethics at the level of the individual company (such as, for example, the corporate governance codes) in the U.K. are an effective monitoring mechanism. Hattori (2002) also investigated the growing concern with corporate ethics and argues that the reason for the increased interest in business ethics is the high number of corporate scandals. He suggests that Japanese companies have to make serious efforts in the following two areas in order to survive in the global economy: first, all stakeholders must be taken into consideration and corporate governance systems should be built based on the Japanese context; and, second, changes in the corporate governance system of Japan should reflect the Japanese legal system as well as the internal and external environment that affects the economy and management.

The banking system, one of the key characteristics of the Japanese corporate system that has significantly shaped the Japanese corporate governance system, has also been the focus of several research studies. In this area, one of the main issues is the traditional monitoring role of the banks and whether this role is still effective in a context of change. Uchida and Osano (2003) in their study focus upon the role of the banks as a monitoring mechanism: They conclude that banks functioned as a monitoring mechanism before the bubble economy but have, however, not properly fulfilled their monitoring role after the end of the bubble economy. Similarly, Hirota and Miyajima (2001) explain that banks had intervened in their clients' management when they were in financial difficulties or showed an operating deficit, during the 1970s and the 1980s. That function had, however, weakened in the 1990s. Hirota (2001) explains that companies expect banks to provide information and other non financial services and that they anticipate that banks will help them when they go through difficult times. This relationship will, however, change, as companies more and more raise funds from sources other than banks. As a result, the relationship between banks and companies will be weakened. Research has shown that as the relationship between banks and Japanese companies has changed and banks had suffered from a serious management crisis, market and institutional shareholders have become more and more important for Japanese companies as a source of funding. Mizuguchi (1994), for example, argues that the equity market plays two roles: first, it acts as a check on companies through day to day changes in share prices; and, second, it is a place where the changing composition of shareholders impacts upon companies. Cross shareholding practice, according to Mizuguchi (1994) adversely affects this checking mechanism of the market because management is immune to pressure from shareholders in the context of cross shareholdings. Kagono (2000) refers to the responsibility of shareholders because large shareholders not only impact upon management policy but also on the equity market. He remarks that although large shareholders' activity may encourage sound management practices, at the same time they may hinder the growth of such practices as some large shareholders might hold shares in order to gain from the sale of their shares. Kagono (2000) thus suggests that there is a need to consider establishing effective measures so as to prevent negative management practices caused by the irresponsibility of large shareholders.

Further, there are several papers, which put an emphasis on the interrelationship between cross shareholding and Japanese corporate governance. The main focuses of these papers are historical developments of the cross shareholding practice in Japanese companies, how this practice contributed to Japan's economic growth, and what kind of adverse affect this practice had on the Japanese corporate governance system (Miyajima et al., 2003, Kitsuki and Nagakubo 1997). Kitsuki and Nagakubo (1997) in an historical study on cross shareholding point out that, as an outcome of cross shareholding, shareholders could not monitor management properly. They argue that this phenomenon has both good and bad aspects: the advantage of a lack of monitoring is that managers can manage their companies freely and this might have better facilitated their growth; the disadvantage is that shareholders cannot monitor their companies due to cross shareholding and thus significantly lost control.

3.2. A CRITICAL ASSESSMENT OF THE LITERATURE

The issues and themes addressed in the English literature more generally reflect the Anglo-American model of corporate governance with its focus on shareholder wealth maximisation. Key issues addressed are corporate performance and various components of the monitoring mechanism of the Anglo-American corporate governance system (such as, for example, the board of directors and executive compensation). There is also an emphasis on describing and assessing key elements of the Japanese corporate system, which are significantly different from the Anglo-

American corporate system. These include cross shareholdings (especially in the context of *keiretsu*), the role of the main bank and Japanese employment practices (such as, for example, lifelong employment, seniority based pay and promotion). There seems to be an ethnocentric tendency in some of the literature in such elaborations of the Japanese system. The Japanese system is often described as being lacking as compared to the Anglo-American. From this perspective Japanese corporate governance is 'weak' and components of the Japanese corporate system are inadequate and need to be improved through implementing elements of the Anglo-American system. In such assessments of the Japanese system, no attempt has been made to appreciate the sense in which Japanese corporate governance as an embedded practice interrelates with the Japanese corporate system and the wider socio-economic and political context. The insistency of the superiority of the Anglo-American system also reflects a form of Westerncentrism, in particular an emphasis on the superiority of Anglo-American practice. There are several references in the literature to the Anglo-American model of corporate governance as the 'global standard' (Yamaguchi, 1998, 1999).[14] The way in which the superiority of the Anglo-American model of corporate governance is taken-for-granted and remains unchallenged indicates the hegemonic status of the Anglo-American model. Much of the literature employing an agency theory approach reflects the above tendencies. Interestingly, the tendency to take the Anglo-American model of corporate governance for granted can also be observed in literature that recognises and highlights the unique characteristics of the Japanese

[14] Similarly, Gallhofer and Haslam (2007) have argued that IASs/IFRSs have also taken on the role of a 'global', albeit mainly influenced by UK and US thought, standard.

context (for example in terms of culture). When aspects of corporate governance are discussed in such literature, the choice of focus reflects the Anglo-American model (for example, the board of directors, see Amadajan and Okumura, 2006). There is a lack of literature, which takes as a starting point for analysis the Japanese system and provides an appreciation of this system as one embedded and thus interrelating with particular Japanese as well as a global context. A noteworthy exception in the English literature is Dore (2003) who emphasises in his analyses how the Japanese corporate governance system and Japanese corporate system are shaped by and in turn shape the specific Japanese context. Dore's assessment of the Japanese system therefore differs in terms of emphasis and appreciation.

The literature on corporate governance in the Japanese language differs from the literature in the English language in several ways. The literature on Japanese corporate governance in the Japanese language to a large extent also focuses on similar issues as the English literature. Studies have focused on the board of directors, considered remuneration systems, elaborated upon the role of the bank as important monitors of management and analysed cross shareholdings. There is, however, an important difference between the Japanese literature on corporate governance and the English literature on corporate governance: the Japanese literature in the main is much more cautious about implementing changes to the Japanese corporate governance system that reflect elements of the Anglo-American corporate governance system. Indeed, research has been critical about especially the U.S. corporate governance system. Research has especially cautioned against a wholesale acceptance of the U.S. corporate governance system. Such research has pointed to the importance of considering the Japanese cultural and legal traditions. Suggestions and proposals made often recommend that the Japanese corporate governance system should be improved by finding ways forward for improvements within the Japanese corporate governance system. There are papers in the Japanese literature that argue that the traditional Japanese corporate governance system has been adequate even during the last recession in 1990s, which is evident in the steady corporate performance of companies that mainly engage in exporting (Egawa 2003, 2005).

Further and interestingly, there does not appear to be a strong ethnocentric bias in assessments of the U.S. corporate governance system. What is found in the literature instead is a concern to point to the cultural differences between the U.S. and Japan, which have shaped the corporate governance system.

In summary, there is a large body of literature in the English as well as the Japanese language, which focuses upon corporate governance in Japan. It is of interest, however, that there is a paucity of studies that adopt an explicitly critical theoretical perspective in their analysis. Further, not many studies offer detailed analyses of documents issued by the various constituencies during the period from 1989 to 2007, the issues and trends in the public discourse, and the way the Japanese government impacted upon the development of corporate governance in Japan. This study here contributes to knowledge in several ways: first, it adopts a critical theoretical perspective to the analysis of corporate governance in Japan, second, it offers an analysis of the trends and issues in the public debate on corporate governance as evident in newspapers; third, it provides a summary of key pronouncement of various constituencies contributing to the debate on corporate governance in Japan; fourth, through two case studies it provides insights into how the pressure to change the Japanese corporate governance system and to converge with the Anglo-American model of corporate governance was perceived and acted upon by the Japanese government and the *Japan Corporate Governance Forum*; and, sixth, reflecting a critical theoretical position that study here makes some proposals for change. It is of note that this research here through adopting a critical theoretical perspective on corporate governance, contrasts with and goes beyond research that has either applied an agency theory perspective or a stakeholder theory perspective. In contrast, it aims to develop its argumentation about Japanese corporate governance and the challenges it faces by appreciating the particularities of the Japanese corporate governance system and the Japanese context. Further, the analysis of the empirical sites aims to provide insights into how corporate governance systems are evolving as part of political struggles in a global context.

3.3. SUMMARY

Chapter three has offered a review of the literature. Reflecting the interdisciplinary character of this study, the chapter discussed contributions to the literature from a variety of disciplines, including, accounting and finance, economics, management, human resource management, law, politics, sociology, international relations and Japan Studies. It identified trends, issues and themes in the literatures in the English and Japanese language on corporate governance in Japan. The analysis indicates that the literature in both languages addresses similar key issues, such as, for example, the board of directors, ownership structure, executive compensation, the banks as providers of capital and accounting disclosure. There is a difference, however, in the assessment of the changes taking place in Japan. The literature in Japanese is much more critical in assessing the Anglo-American corporate governance model and the suggestion that Japan should converge with this model than is the case for the literature in English. The chapter ended by outlining the contribution to knowledge of this study. The next chapter, chapter 4, addresses issues of methodology from a critical theoretical perspective and outlines the methods adopted in this study.

CHAPTER 4

METHODOLOGY AND METHOD: A CRITICAL THEORETICAL OVERVIEW

This chapter addresses questions of methodology and method and their interrelationship with the theoretical position. It initially elaborates the way in which theoretical position, research design and method are interrelated[15]. This includes a brief elaboration of ontological and epistemological assumptions. The chapter then provides a rationale for and an outline of the particular case study methodology that is adopted in this study and how this provides insights into the research questions that the thesis aims to explore. This is followed by a rationale for and a brief description of the type of empirical material analysed, including a description of the methods employed in the analysis of the empirical material. The chapter ends with an elaboration of the Critical Systems Model that is employed in the analysis of the empirics.

4.1. ONTOLOGICAL AND EPISTEMOLOGICAL CONSIDERATIONS[16]

[15] This chapter responds to here is confusion in the literature about the terms theoretical position, methodology and methods, using the delineations offered by Crotty (1998, pp. 2-4). A *theoretical position* is an approach to understanding and explaining society and the human world and the philosophical stance informing the methodology. A *methodology*, reflecting this philosophy, may be understood in terms of a research design that guides the research in choosing methods and shapes the design of the methods chosen. It is the analysis of how the research should or does proceed. *Methods* are the techniques or procedures used to collect and anlyse data related to the research question.

[16] Epistemology here refers to the theory of 'knowing' that is embedded in a theoretical perspective and ontology refers to the theory of 'being' embedded in a theoretical position (Crotty, 1998).

There is debate in the literature in accounting and finance and the social sciences more generally about how theoretical positions, methodology and method are interrelated and how this affects the design of a research study. It is possible to identify two broad positions in these debates. First, there is the view that there is a causal relationship between theoretical perspective, methodology and method. Such a view would hold that particular types of methods are linked to particular theories and that the epistemological and ontological assumptions underpinning these theories determine the types of methods that should be used. In such argumentation positivist epistemological and ontological positions are linked to quantitative research methods and interpretivist epistemological and ontological positions to qualitative research methods. Second, there is the view that the relationship between theoretical position, method and methodology is less straightforward. Such a view would hold that in certain circumstances or in some sense interpretivist theoretical positions can be combined with quantitative research methods (Blaikie, p. 1993, 201). A brief elaboration of positivist and interpretivist ontological and epistemological assumptions helps to explain these two views on the impact of theoretical positions on the choice of methods.

In positivistic ontological positions, social reality is understood to be an ordered universe that consists of observable events. The ability to observe these events indicates that they are real. According to such a position, human activity can be observed as it takes place in an observable context. Further, social reality consists of events that are linked through causal relations. Important in this argumentation is that what causes human behaviour is understood to be external to the individual. The above ontological assumptions are reflected in the epistemological assumptions of positivistic positions. Knowledge is derived through observation of facts by the researcher who is a neutral observer and whose own experiences and context do not enter knowledge creation. Knowledge derived in this way is understood to be the only legitimate form of knowledge. Positivistic positions are a product of the Enlightenment (the Age of Reason)[17] and were initially developed in the context of the natural sciences. They soon became, however, applied in the social sciences in an attempt to enhance their scientific character. The value of positivistic positions was especially appreciated in the social sciences since the nineteenth century, when Emile Durkheim (1858-1917) stressed that social facts take on the characteristics of things in general and that society should therefore be studied by using the methods of natural science, which can be understood as the study of things (Jones, 2003, pp. 31-53). Positivistic positions soon gained popularity and they now constitute the mainstream approach in social science disciplines. This is also the case in finance and accounting. The finance literature, which is based on neo-classical economics and the literature in accounting, which employs positive accounting theory, are thus underpinned by positivistic ontological and epistemological assumptions (Ryan, et al, 2002). Relatedly, there is a mainstream body of literature on corporate governance, which uses quantitative research methods in the context of positivistic approaches to research.

[17] Alvesson and Deetz (2000, p. 13) explain that in respect to Western Enlightenment that 'Kant described the Enlightenment as the escape from self-inflicted tutelage'.

The positivistic approach to research in the social sciences, however, did not remain unchallenged. As early as the eighteenth century, philosophical positions had emerged that offered an interpretive alternative to positivistic conceptions of the world and knowledge. Jean-Jacques Rousseau (1712-1778) was an important representative of the interpretive position, which had a conception of the individual as belonging to a wider social and cultural entity (Hughes and Sharrock, 1990). This argumentation was further enhanced in the nineteenth century by historians who addressed the following related questions: first, "Can the study of history be a natural science or does it have to develop its own distinctively human inquiry?", and, second, "How do we come to terms with the fact that history involves the understanding and self-understanding on the part of those human beings under study?" It was concluded that the study of history, i.e. the study of human behaviour and actions, needed different methods to that of the natural sciences (Hughes and Sharrock, 1990).

The above elaboration already implicitly points to the different ontological and epistemological assumptions that underpin interpretive positions. In these positions social reality is understood as a complex set of socially constructed meanings. This implies that, in contrast to positivism, that social reality is not an ordered universe that consists of observable events. Social reality therefore cannot be understood as a thing that may be interpreted in different ways; it is those interpretations (Hughes and Sharrock, 1990). Knowledge is therefore understood to be derived from gaining insights into everyday concepts and meanings. The social researcher aims to understand the socially constructed meanings through entering the social world.

The above elaborations of the characteristics of positivistic and interpretive positions facilitate understanding of the two views (outlined above) on how theoretical positions and choice of methods are interrelated. If one is concerned to strictly match methods with theoretical positions on the basis of their ontological and epistemological positions then it seems reasonable to suggest that positivistic theoretical positions should be matched with quantitative methods and interpretive theoretical positions with qualitative methods. This position in terms of choice of method has, however, been challenged and the view has emerged that the interrelationship between theory, methodology and method is not absolutely deterministic. Blaikie (1993, p.215) argues in this respect:

> No one approach and strategy, and its accompanying choices on these issues, provides a perfect solution for the researcher, there is no one ideal way to gain knowledge of the social world. All approaches and strategies involve assumptions, judgments and compromises' all are claimed to have deficiencies. However, depending on where one stands, it is possible to argue their relative merits.

It can thus be argued that the researchers based on their research interests and the theoretical position they employ will tend to have a preference for particular types of methodologies and methods. Researchers employing interdisciplinary perspectives, and especially with a critical intent[18] (for example, critical theoretical perspectives, indigenous perspectives and feminist perspectives), may use qualitative as well as quantitative research methods in their research design. Most commonly, research employing critical perspectives is still "structured along the lines of the powerful examplar rather than a mass of data" (Alvesson and Deetz, 2000, p.18). The justification for this choice of method is that individual experiences can be much better documented through in-depth research methods (for example, the various types of interview methods developed by indigenous researchers and feminist researchers). There are, however, instances where quantitative methodologies and methods are used despite the interpretivist ontological and epistemological assumptions that underpin these critical perspectives. In such cases, the choice of quantitative methods by critical researchers most likely reflects their intention to engage in debate through their research insights and the type of research questions they use (Alvesson and Deetz, 2000). For example, if it is the objective of the researcher to engender change and public debate through research insights, quantitative methods might be much more effective given the general positive public perception of facts. The power of facts and numbers was already recognised by the Frankfurt School (for example, Horkheimer and Adorno in their work on the authoritative character type).

[18] Critical intent here refers to the position taken by the researcher to engender emancipatory change with the view of facilitating the realisation of the potential of individuals, communities and organisations with the overarching goal being global well-being (Gallhofer and Haslam, 2009).

Quantitative research methods are now variously employed together with interpretive research methods in studies informed by critical theoretical positions.[19]

The next section of the chapter outlines the research design of the thesis; explains the way in which the empirical material was chosen and the methods employed in the analysis of the empirical material.

4.2. RESEARCH DESIGN, CRITICAL CASE STUDY AND *CRITICAL SYSTEMS MODEL (CSM)*

The study employs a critical case study methodology, which like the critical theoretical perspective adopted, reflects interpretivist ontological and epistemological assumptions. The choice of research design and methods here was motivated by the specific research questions, which in turn reflect the critical intent to challenge taken-for-granted assumptions and perceptions (that is, of the Japanese and Anglo-American corporate governance systems). As it is an objective of the research to gain insights into what happens to Japanese corporate governance in the context of pressures to change it was decided to choose the case study methodology in order to get in depth insights into the issues at stake. The "powerful examplar rather than a mass of data" (Alvesson and Deetz, 2000, p.18) facilitates here the critical research intent. At the same time there is a need to locate these two case studies in the broader public debate, that is, to appreciate how the issues they

[19] An example for such a type of research is the paper by Gallhofer et al. (2000), which uses a web survey and interviews to gain insights into enabling dimensions of online reporting.

discussed and were concerned about reflected the issues and trends of the public discourse of the time. In order to gain insights into the trends and issues of the broader public debate a content analysis of a sample of Japanese newspapers was conducted. The combination of case study analysis and content analysis facilitates the type of social analysis employed in this study (see below).

The empirical sites for the case studies are: first, bilateral trade negotiations between Japan and US, and, second, the development of the *Corporate Governance Principles* of the *Japan Corporate Governance Forum*. In both cases, corporate governance is discussed in the context of change, i.e. a context in which there is pressure to change the traditional Japanese corporate governance system. Both empirical sites are significant instances of regulatory intervention reflecting the Japanese context. The first empirical site, the bilateral trade negotiations, shows how the Japanese government, originally the sole and since the introduction of the stock exchange after World War II a joint regulator of corporations, acts in the context of pressures to change the corporate governance system through implementing (or not implementing) required changes into Japanese law. The second empirical site, the *Japan Corporate Governance Forum*, is an instance of an attempt at self-regulation, in an area that traditionally was a domain of the law. It is of interest to gain insights into the way the *Japan Corporate Governance Forum* responded to the pressures for change in designing their *Corporate Governance Principles* and the contextual constraints that facilitated or hindered this process. The insights gained from the detailed analysis of the empirical material shed light on several issues that reflect the concerns of a critical theoretical perspective: for example, the unequal power relations (between groups and between states, for instance); the tensions between different values, including cultural value, underpinning corporate governance systems; the perceived impact of the pressures to modify or replace the traditional Japanese corporate governance system on the way of life and the well-being of people living in Japan; and the way in which the dynamics and tensions constitute threats and opportunities from a critical theoretical perspective.

The research process employed in the two case studies reflects the critical theoretical perspective adopted. Alvesson and Deetz (2000, p.17) refer in this context to three "overlapping" tasks of research, namely, "insight", "critique" and "transformative redefinition". They explain:

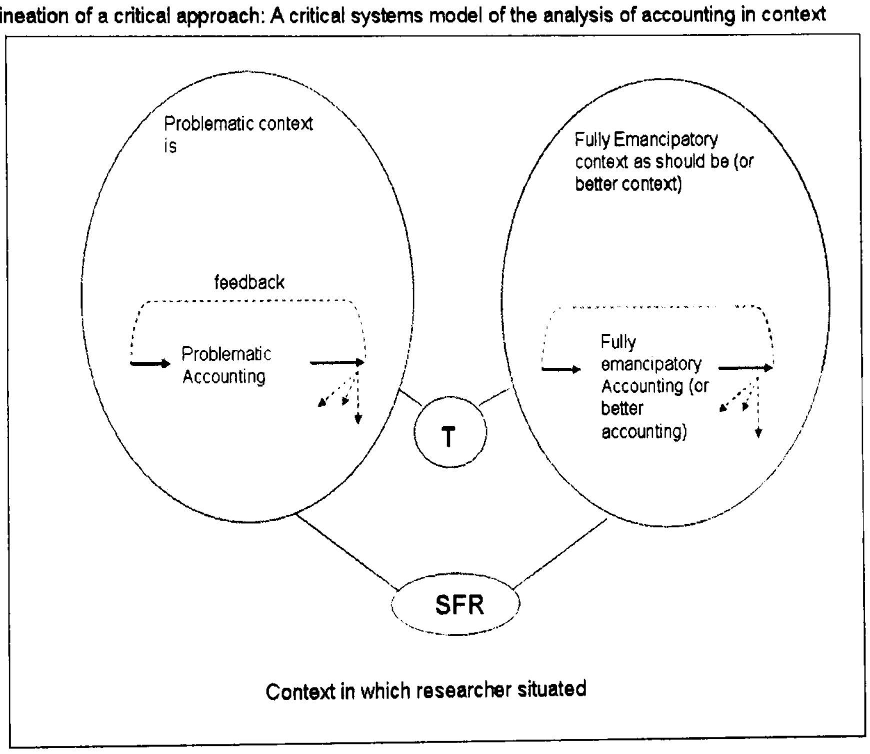
> The insights task demonstrates our commitment to the hermeneutic, interpretive and ethnographic goals of local understandings closely connected to and appreciative of the lives of real people in real situations. The critique task demonstrates out commitment to the analytical aspects of critical traditions which recognize the possibility of domination in local formations and to reconnect local forms and meanings to larger social, historical and political processes. The transformative redefinition task demonstrates our commitment to the more pragmatic aspects of critical thought, recognizing that insight and critique without support for social action leaves research detached and sterile (Alvesson and Deetz, 2000, p. 17).

Related to this, the research process here follows the *Critical Systems Model (CSM)* as outlined by Gallhofer and Haslam (2008, pp.12-17).

The Critical Systems Model offers a way of analysing accounting and social phenomena more generally as embedded in context. It reflects the concern of a critical theoretical perspective to engender enabling emancipatory change and thus emphasises transformation to the better. In the following the Critical Systems Model is elaborated with reference to corporate governance.

Figure one.

Delineation of a critical approach: A critical systems model of the analysis of accounting in context



Note: T = transformation; SFR = situated focal researcher

Figure 1: The Critical Systems Model (Gallhofer and Haslam, 2008, p. 13)

The left side of the model depicts corporate governance as embedded in its current problematic contexts. Through critique, positive and negative attributes of the Japanese corporate governance system are identified in relation to the problematic context they are embedded in. The right side of the model depicts a better Japanese corporate governance system that the researcher initially proposes in order to engender debates. The researcher also aims at suggesting strategies for how the move from a current problematic corporate governance system to a better system may be achieved. The Critical Systems Model, reflecting the critical theoretical perspective employed in this study, emphasises that change towards a better corporate governance system (to the extent it occurs) may be understood as along continuum. Over time, and through engagement, dimensions of the model change.

4.3. RESEARCH METHODS

Following the above research approach, textual analyses of the empirical material are carried out so as to gain insights into the issues addressed in the research questions outlined in Chapter 1. Consistent with a critical theoretical perspective, the study employs methods through a critical and interpretive lens. Critical here means that the methods chosen help to develop argumentation in the context of the debate over corporate governance in Japan that aims to shed light on possible tensions that might arise because of, for example, cultural differences reflected in different corporate governance systems and unequal power relations between the groups involved in the debate. The critical lens, however, not only impacts upon the choice of methods for this study but also on the way in which the methods are applied. That is, methods are not followed "like a rule book" but they are variously shaped and modified so as to facilitate the development of the argumentation of this study. This implies that not all elements and parts that constitute a particular method are applied in this study but only those parts of a particular method are chosen that are especially deemed to facilitate the critical social analysis aimed at here. The interpretive lens supports and provides further justification for such a use of method. Acknowledging that no truth exists that can be uncovered by the researcher through the precise application of a particular method the interpretive lens supports partial application and modification of methods by the researcher if this is to better facilitate his or her task (cf. Gallhofer et al., 2001a).

Based on the above considerations, this study employs two types of textual analysis: first, a quantitative content analysis (but informed by and through a critical interpretive lens and motivation), and, second, a critical interpretive textual analysis. The former is concerned to broadly outline trends in and issues of the public debate on corporate governance in Japan as evident in newspapers whereas the latter aims to provide insights into how specific participants (the Japanese government and the *Japan Corporate Governance Forum*) in the debate developed arguments in relation to corporate governance in Japan, which reflect their particular location in the broarder public debate and the Japanese and global context more generally. The next section explains how the two methods have been employed in this study.

4.3.1. Content Analysis

Krippendorf (2004, p. 3) points out that '[a]lthough the term *content analysis* [emphasis in original] did not appear in English until 1941...the systematic analysis of texts can be traced back to inquisitorial pursuits by the Church in the 17th century'. Content analysis, as a distinct research method, was originally developed in the context of the study of mass communication, especially newspapers. In a general sense it is concerned to code texts by using content categories in order to identify the frequency with which these content categories appear in the texts analysed (see, for example, George, 2009, p. 145). After the Second World War, other social science disciplines began to employ the content analysis method (Krippendorff, 2004). Since then, content analysis has been significantly developed and today constitutes a key research method for the social sciences. As Krippendorff (2004) argues:

> Content analysis is potentially one of the most important research techniques in the social sciences. The content analyst views data as representations not of physical events but of texts, images, and expressions that are created to be seen, read, interpreted, and acted on for their meanings, and must therefore be analyzed with such uses in mind. Analyzing texts in the context of their uses distinguishes content analysis from other methods of inquiry (Krippendorff, 2004, p. xiii).

This study here applies content analysis in the way it is advocated by Krippendorff above. The texts, i.e. the newspapers, are understood to constitute an element of a public debate over corporate governance embedded in a particular Japanese context as well as a more general global context. And, the newspapers themselves are understood to constitute the broader context in which the debates of the two case studies (i.e. the bilaterial trade negotiations between Japan and the U.S. and the *Corporate Governance Principles* of the *Japan Corporate Governance Forum*) are embedded.

Content analysis has been widely employed by researchers in accounting. It especially has gained popularity in the areas of social and environmental accounting and corporate social responsibility reporting. In these areas, content analysis was employed to gain insights into the extent and characteristics of the voluntary disclosure of social and environmental information by corporations (Kuasirikun and Sherer, 2004, p. 635). Earlier studies focused on the printed annual report or the various forms of stand alone corporate social responsibility reports (see, for example, Jaggi, 1980; Guthrie and Parker, 1990; Gray et al., 1995; Adams and Kuasirikun, 2000; Moneva and Llena, 2000; Gallhofer et al., 2001b; Kuasirikun and Sherer, 2004). More recently, and especially with the advancement of the internet as a tool of information disclosure for corporations, studies have increasingly begun to focus on corporate web-sites or the internet more generally (Gallhofer et al., 2000).

Studies in the areas of social and environmental and social responsibility reporting aimed at gaining insights into what types of information were voluntarily disclosed by companies, where it was disclosed, how it was disclosed and how much was disclosed. Longitudinal studies were interested in identifying trends in the disclosure of companies over particular periods and comparative studies, most of them focusing at short time periods, aimed at identifying differences and similarities in the voluntary disclosure of social and environmental information across countries (see, for example, Jaggi, 1980; Guthrie and Parker, 1990; Gray et al., 1995; Adams and Harte, 1998; Adams and Kuasirikun, 2000; Gallhofer et al., 2001b; Kuasirikun and Sherer, 2004). Although there has been a significant increase in studies using content analysis in the area of social and environmental reporting, there is a paucity of studies employing content analysis to identify trends in the corporate governance reporting of companies.

Some of the studies in the area of social and environmental or corporate social responsibility reporting that utilize content analysis are especially of interest to this study here because of their particular application of this research method. Such studies have employed content analysis, a quantitative method, in the context of an interpretivist theoretical position (Gallhofer et al., 2001b, Kuasirikun and Sherer, 2004). Gallhofer et al. (2001a) employed a critical theoretical framework in their analysis of the results of a content analysis of annual reports. They developed a critique of the regulatory framework of environmental reporting based on their content analysis of annual reports. From a critical theoretical perspective, they argued for more legal prescription in the context of environmental reporting. Similarly, Kuasirikun and Sherer (2004) in their analysis of corporate social accounting disclosure in Thailand also based their critique of the reporting practices of Thai companies on a content analysis of annual reports. They explain:

> [The study's] concern is to gain insights into and to critically appraise various dimensions of these annual reports, so as to construct a critique of corporate social disclosure in Thailand. Pursuing a critical perspective sensitive to the context of Thailand, it is concluded that the various aspects of the Thai accounting disclosure that are analysed are disabling, and more generally that the Thai practices explored fall short of their

> potential to function as enabling communication (Kuasirikun and Sherer, 2004, p. 629).

The particular interpretive and critical theoretical positions adopted by the researchers above impacted upon how content analysis was employed in these studies. In both studies content analysis was used to show trends in the reporting. For example, through content analysis it was highlighted what types of issues were disclosed, the volume of disclosure, how the information was disclosed and where within the annual report it was disclosed. In addition to the quantitative content analysis, interpretive textual analyses of examples of the particular types of disclosures that had featured in the content analysis were offered. In the context of the particular research design adopted in the studies by Gallhofer et al. (2001b) and Kuasirikun and Sherer (2004), the quantitative content analysis offers a broad overview of general trends in the reporting of social and environmental accounting information whereas the qualitative textual analysis provides detailed insights into the particular ways in which this information is communicated to the readers of annual reports. It may be argued that applying both research methods in this way provides a more holistic insight into the social and environmental reporting practices of companies than simply employing either of the methods. An interplay between macro-level and micro-level analyses that achieves a more holistic appreciation of the reporting practices. Further, both studies did not carry out statistical tests of the data they had obtained from their content analysis. The reason for this is that for the purposes of their studies it was sufficient to simply present the data either in its raw form or in the form of percentages.

The study here also employs content analysis in the way outlined above in order to show trends of and issues discussed in the public debate over corporate governance in Japan as evident in newspapers. A quantitative content analysis is carried out, which, as George (2009, p. 145) has explained, 'is concerned with the frequency of occurrence of given content characteristics'[20]. More particularly, this study is concerned to gain insights into the frequency with which content categories are referred to (at least once) in newspaper articles over the period under focus here. The next section of the chapter outlines how the sample for the content analysis of this study was chosen and how the content categories of the analysis arrived at.

As mentioned earlier, it was decided to use a content analysis of newspapers to gain insights into the issues and trends of the wider public discourse in which the debates in the two case studies were embedded. It is reasonable to argue that newspapers, being a part of the media, reflect issues and concerns of what can be called a public discourse (Krippendorf, 2004).

4.3.1. 1. Sample

As the aim of the study is to gain insights into the corporate governance debate occurring in Japan, only Japanese newspapers were selected. The concern here is to get an appreciation of the broad, i.e. general, public discourse. In order to achieve

[20] This paper by Alexander George included in Krippendorff and Bock (2009), was originally published in 1949.

this, national newspapers were chosen for the analysis.[21] It was decided to differentiate between the types of daily newspapers: first, general newspapers, and, second, specialist financial newspapers. This categorisation of newspapers may provide insights into whether there are differences between concerns raised and issues addressed in the reporting of the national financial daily newspapers and the national general daily newspapers. Differences and similarities between these categories of newspapers would indicate the extent to which the concerns of the financial community have permeated and were shared by the general public discourse. Daily circulation rates were taken into account in choosing the sample of newspapers for the analysis. Reporting in newspapers with high circulation rates was taken as better reflecting concerns in effect emerging in the general public

Financial Newspapers	
Japanese Name	**English Name**
Nihon Keizai Shimbun Nikkei Kinyu Shimbun Nikkei Sangyou Shimbun	(no English name) (Financial Daily) (Nikkei Business Daily)
General Daily Newspapers	
Japanese Name	**English Name**
Asahi Shimbun Mainichi Shimbun Sankei Shimbun Yomiuri Shimbun	(no English name) (no English name) (no English name) (no English name)

Table 1: Newspapers included in the Sample

[21] An analysis aimed at identifying regional variations within the public discourse would go far beyond the scope of this study here and warrant study in its own right.

discourse. In choosing the sample of daily national newspapers, the political affiliation of the newspapers was also taken into account to ensure that the analysis of the trends in reporting would capture the general public discourse. The sample selection criteria resulted in a final sample of seven newspapers, as shown in Table 1.

The three daily financial newspapers of the sample are all published by Nikkei Inc., a publishing company established in 1876, which, according to its president, aims to 'contribute to the peaceful and democratic development of the Japanese economy – the basis of people's livelihoods – by providing fair and impartial news reports' (Nikkei, 2009a). Nihon Keizai Shimbun is the largest of the three daily financial newspapers. According to its web-site, it offers 'timely and objective coverage of corporate news and macroeconomic trends, from conditions in Japan and overseas to investment and management strategies' (Nikkei, 2009c). *Nikkei Sangyo Shimbun* (Business Daily) is a daily specialist newspaper, which provides microeconomic information, such as, for example, developments in cutting edge technologies and innovative products and services' (*ibid.*) and is read by 'professionals in corporate analysis and investment, including securities analysts and fund managers' (*ibid.*). *Nikkei Kinyu Shimbun* (Financial Daily) is a specialist financial newspaper, which was discontinued on 21 January 2008 and replaced by the new weekly finance and investment newspaper *Nikkei Veritas* (Sankei News, 2007)[22]. The four daily general newspapers are all published by different publishing companies, some of which have also been established in the latter half of the nineteenth century. The *Asahi Shimbun* company, for example, published the first version of its newspaper *Asahi Shimbun* in 1879 (The Asahi Shimbun, 2009a). *Asahi Shimbun*, according to its website, is 'the choice of Japan's opinion leaders and decision makers in the various business scenes' (*ibid*). Their readers are highly educated and affluent people who take up managerial positions of corporations' (*ibid.*). *Yomiuri Shimbun* was established in 1874. Since 1977 *Yomiuri Shimbun* have had the highest circulation rate amongst Japanese newspapers. According to its website, its readers 'have substantial purchasing power' (Yomiuri Shimbun, 2009). *Mainich Shimbun* was established in 1872 and its readers are interested in issues that Japan is currently facing, such as the environment, the problems associated with an aging society and corporate social responsibility. According to the newspaper's website its readers earn a substantial annual income (Mainich Shimbun, 2009). *Sankei Shimbun* was established in 1933. Its readers mainly live in big cities and their average age is around forty seven years (Sankei Shimbun, 2009a, b, c).

The seven newspapers have a combined daily circulation rate of nearly 38 million copies (see Table 2 for daily circulation rates). *Nikkei Keizai Shimbun* is the largest daily economic and business newspaper in Japan as per circulation with a daily

[22] *Nikkei Kinyu Shimbun* (Financial Daily) was included in the sample as it constituted one of the top three Japanese daily newspapers specialising in financial and economic issues during the period focused upon in this study.

circulation rate of over three million copies (approaching five million of the evening circulation is added). In contrast, the other two daily financial newspapers included in the sample have comparatively small daily circulation rates, which is partly reflective of the specialist readership they are targeting.

Financial Newspapers			
	Daily Circulation		
Name	**Morning**	**Evening**	**Total**
Nihon Keizai Shimbun	3,056,038	1,619,360	4,675,398[25]
Nikkei Sangyou Shimbun	167,144[23]	n/a	
Nikkei Kinyu Shimbun	65,000[24]	n/a	
General Daily Newspapers			
	Daily Circulation		
Name	**Morning**	**Evening**	**Total**
Yomiuri Shimbun	10,016,894	3,782,579	13,799,473[26]
Asahi Shimbun	8,033,400	3,427,061	11,460,461[27]
Mainichi Shimbun	3,880,632	1,323,715	5,204,347[28]
Sankei Shimbun	1,921,075	571,710	2,492,785[29]
All Newspapers	**27,140,183**	**10,724,425**	**37,632,464**

Table 2: Daily Circulation Rate

Yomiuri Shimbun is the largest daily general newspaper measured by daily circulation rate. Nearly 14 million copies of this newspaper are sold and distributed

[23] The figure constitutes the average for the period from July to December 2009 (Nikkei, 2009d).
[24] No precise circulation figures were available for this newspaper. The figure in the table constitutes the average of a peak circulation of 90,000 (no date available) and a circulation of 40,000 at the end of 2007.
[25] The figure constitutes the average for the period from July to December 2008 (Yomiuri, 2009).
[26] The figure constitutes the average for the period from July to December 2008 (Yomiuri, 2009).
[27] The figure constitutes the average for the period from July to December 2008 (Yomiuri, 2009).
[28] The figure constitutes the average for the period from January to June 2008 (Mainichi Shimbun Advertising Division Cyberspace, 2009).
[29] The figure constitutes the average for the period from July to December 2008 (Sankei Shimbun, 2009).

every day. Yomiuri Shimbun is closely followed by Asahi Shimbun, which reaches a distribution rate of around 11 million. Compared with these daily newspapers, the other two daily newspapers included in the sample are relatively small. Mainichi Shimbun achieves a daily distribution rate of nearly 5 million copies and Sankei Shimbum one of nearly 2.5 million copies. Daily circulation rates indicate how many copies of a particular newspaper were sold and distributed each day but

Newspaper	1 person	2 persons	3 persons	4 persons	5 or more persons	0 person	unknown	Total
Asahi	10.6	44.1	24.1	13.4	5.1	0.1	2.7	2.6
Mainichi	10.1	42.6	24.5	14.9	5.6	0.0	2.4	2.7
Yomiuri	9.4	43.8	23.5	15.9	4.9	0.0	2.5	2.6
Sankei	13.2	43.3	21.4	14.5	5.5	0.0	2.2	2.6
Nihon Keizai Shimbun	37.3	44.0	11.2	5.0	0.6	0.0	2.0	1.9

Table 3: Estimates of Percentage of Different Numbers of Readers per Copy (National, Morning Edition) (The Ashahi Shimbun, 2009b)

do not provide any indication of the number of people who actually read a particular copy. A large part of the circulation of daily newspapers normally is to households with more than one reader per copy. Table 3 shows that the number of readers for all four daily newspapers and the largest specialist financial newspaper in the sample is higher than one[30]. The daily general newspapers, with the exception of Mainichi Shimbun, which has 2.7 readers per copy, all achieve 2.6 readers per copy. Nihon Keizai Shimbun, the leading daily financial newspaper, has 1.9 readers per copy. As Table 4 indicates, the five largest newspapers in Japan,

[30] The data for the number of readers per newspaper is for 2006 (The Asahi Shimbun, 2009b). No later data was available. No data was available for Nikkei Sangyou Shimbun and Nikkei Kinyu Shimbun.

which are published daily, are read by over 68 million people every day. Given the large number of readers of these newspapers it is on the face of it reasonable to consider the reporting of corporate governance in these newspapers as having some

Financial Newspaper		
	Morning Edition (circulation)	**Readers**
Nihon Keizai Shimbun	3,056,038	5,806,472
General Daily Newspapers		
	Morning Edition (circulation)	**Readers**
Yomiuri Shimbun	10,016,894	26,043,924
Asahi Shimbun	8,033,400	20,886,840
Mainichi Shimbun	3,880,632	10,477,706
Sankei Shimbun	1,921,075	4,994795
All Newspapers	**26,908,039**	**68,209,737**

Table 4: Total Number of Readers of the Morning Editions

resonance with the constitution or construction of concerns and issues in the broader public discourse.

It is of interest to look at the composition of the readership of the five largest newspapers in the sample in more detail. All five daily newspapers (general and financial) are read by all age and gender groups (The Asahi Shimbun, 2009b). The educational background of the readers of these five newspapers is also high reflecting the high educational background of Japan more generally. Table 5 provides some information on the educational background of the readers of the five largest daily newspapers in Japan. Readers of these five newspapers, according to Asahi Shimbun (2009b), include 'powerful decision-makers' (including, for example, managers of Ministries, University Presidents, product mangers of listed

Daily General and Financial Newspaper		
Educational Background	**Asahi Shimbun** **Should this be the leading financial paper**	Asahi Shimbun Mainichi Shimbun Sankei Shimbun Yomiuri Shimbun
Still in School	12.3	9.9
Junior High School	3.9	8.1
High School	29.9	41.7
Junior College	20.0	18.4
University Graduate School	33.2	21.0
Unknown	0.7	0.9

Table 5: The Educational Background of Readers (percentage)[31]

companies, CSR department chiefs of listed companies; *ibid.*), 'prominent business people' as well as 'affluent consumers' (*ibid.*). In short, many influential people are understood to read these papers. The composition of the readership further evidences the influence and importance of these newspapers in reflecting and creating public opinion. An analysis of the issues and concerns addressed in the reporting of these newspapers is thus deemed to provide insights into the concerns and issues constructed in the broader public discourse in which the two empirical sites of the case studies are embedded.

[31] The data is for October 2004 (The Asahi Shimbun, 2009b). Unfortunately no more detailed breakdown of the readerships of the five newspapers was available.

4.3.1.2. Content Categories

The choice of content categories has been informed by the theoretical position taken in this study and the general aims of the study. The content categories thus reflect issues of relevance in a context in which Japanese corporate governance was put under pressure to change and to converge with the Anglo-American corporate governance system. The design of content categories has also been informed by a reading of the literature on the Japanese corporate governance system and the Anglo-American corporate governance system. Table 6 lists the content categories used in the analysis of the sample newspapers. The five main content categories were designed so as to provide insights into trends in the corporate governance reporting of the newspapers and the main issues addressed in terms of the components of the corporate governance system and the characteristics of the corporate system in which the corporate governance system is embedded (main content categories 1 – 3). Main content category 4 aims to identify possible impacts of developments in the wider context on the corporate governance reporting of the Japanese newspapers. And, main content category 5 was designed to gain insights into engagements with corporate governance developments taking place outside of Japan. Where applicable (i.e. main content categories 2 – 5) sub-categories were designed to bring out differentiation within the main content categories. The aim is to indicate particular emphases in the newspaper reporting relating to the main content categories.

MAIN CONTENT CATEGORIES	Sub-Content Categories
1. **Corporate Governance**	n/a
2. **Corporate Governance System**	• board of directors Non-executive Director Executive remuneration • Takeover • Transparency Accounting Disclosure Financial Disclosure Financial Reporting • Audit Internal Audit(or) Financial Audit • Internal Control
3. **Corporate System**	• Cross-shareholdings • Main Bank • Japanese Style Management • Shareholders Shareholder Interest Shareholder Rights • Investors Institutional Investors Foreign Investors
4. **Developments in the Wider Context**	• Commercial Code • Company Act • Securities and Exchange Law • Corporate Scandal • Globalisation
5. **Influence on Corporate Governance from Outside of Japan**	• U.S. U.S. Style board of directors U.S. Style Corporate Governance • U.K. Cadbury (Committee) • IASC/IASB IASs/IFRSs

Table 6: Content Categories

The sample newspapers were analysed employing the above content categories during August 2007. The following online data bases available at *Shimbun Toshokan* (Newspaper Library) in Yokohama were used: *Nikkei Terekon21* (for *Nihon keizai Shimbun, Nikkei Kinyu Shimbun, Nikkei Sangyou Shimbun* and *Mainichi Shimbun*) and the individual company data bases for *Asahi Shimbun, Sankei Shimbun* and *Yomiuri Shimbun*. Table 7 lists the content categories that were searched in the English language and the Japanese language (i.e. the language in which the search was carried out). There were several difficulties in carrying out this search that arose because of the different languages and the different writing systems. In many instances English terms as well as the Japanese translations are interchangeably used in Japanese texts. In those cases the search included the English term as well as the Japanese translation. Further, the Japanese writing system captures the sound of a spoken word. As pronunciations of English terms can vary between people, different spellings of terms can occur. In such cases all commonly used spellings known to this author have been included in the search. In addition, terms can also be written by using one of the three writing systems of the Japanese language (*Kanji, Hiragana* and *Katakana* characters). If this was the case all possible ways of writing the term have been included. For example in the case of the term "corporate governance" there are three acceptable ways of writing this term: first, the Japanese term "kigyoutouchi" written as 企業統治; second the English term written in Katakana characters written as either コーポレートガバナンス or コーポレート・ガバナンス. The title of the articles of the newspapers

CONTENT CATEGORIES	
ENGLISH	**JAPANESE**
Accounting Disclosure	会計情報開示、会計情報の開示、会計ディスクロージャー
Accounting/Financial Audit	会計監査、財務監査
Annual General Meeting	株主総会
Audit(or)	監査、　監査人
board of directors	取締役会
Cadbury Committee	キャドベリー委員会、キャドバリー委員会
Commercial Code	商法
Company Act	会社法
Corporate Governance	企業統治、コーポレートガバナンス、コーポレート・ガバナンス
Corporate Scandal	企業不祥事、会計不祥事、粉飾
Cross-Shareholding/Keiretsu	株式持合い、系列
Disclosure	情報開示、ディスクロージャー
Executive Remuneration	取締役報酬、役員報酬
External Audit(or)	外部監査、会計監査人、公認会計士、監査人監査
Financial Disclosure	財務情報開示、財務情報の開示、財務ディスクロージャー
Financial Reporting	財務報告、会計報告
Foreign Investor	外国人投資家
Globalisation	グローバリゼーション
IAS/IFRS	国際会計基準、国際財務報告基準
IASC/IASB	国際会計基準委員会、国際会計基準審議会
Institutional Investor	機関投資家
Internal Audit(or)	内部監査、監査役、監査役監査、業務監査
Internal Control	内部統制
Investor	投資家
Japanese Style Management Practices	日本的経営、終身雇用、年功序列賃金、年功序列給与、年功序列昇進、年功序列システム
Main Bank	メインバンク
Non-Executive Director	社外取締役、非常勤取締役
Securities and Exchange Law	証券取引法
Shareholder	株主
Shareholder Interest	株主利益
Shareholder Rights	株主権
Stakeholder	利害関係者、ステークホルダー、ステーク・ホルダー
Takeover	買収、敵対的買収
Transparency	経営の透明性、経営の透明度、財務報告の透明性、財務報告の透明度、会計報告の透明性、会計報告の透明度
U.K.	英国、イギリス
U.S.	米国、アメリカ
U.S. Style board of directors	米国型取締役会、アメリカ型取締役会、委員会等設置会社、委員会設置会社
U.S. Style Corporate Governance	米国型企業統治、米国型コーポレートガバナンス、米国型コーポレート・ガバナンス、アメリカ型企業統治、アメリカ型コーポレートガバナンス、アメリカ型コーポレート・ガバナンス

Table 7: Content Categories in English and Japanese

and their whole content were searched to identify those that referred to the content categories listed in table 6. In order to ensure that the articles identified by the search all related to corporate governance the individual content categories were combined with the term "corporate governance" (for example, "corporate governance" and "internal audit"). The results of the content analysis are discussed in Chapter 6.

4.3.2. Critical Interpretive Textual Analysis

Critical interpretive textual analysis is a popular method for analysing texts in the social sciences, including accounting. It is concerned to theorise texts and documents contextually and critically, including with reference to various conflicts, tensions and potentialities of the context (Fairclough, 1992, 2003; Gallhofer et al., 2001b). In the late 1980s a particular type of critical interpretive textual analysis, namely "critical discourse analysis"[32], emerged (Blommaert and Bulcaen, 2000, p. 447) and became a popular research method especially with researchers who assume a critical theoretical position. The reason for this is that, as Blommaert and Bulcaen (2000, p. 447) have argued, critical discourse analysis 'explicitly intends to incorporate social-theoretical insights into discourse analysis and advocates social commitment and interventionism in research'. Norman Fairclough, whose

[32] Discourse analysis was originally developed within the discipline of linguistics and later spread to other social science disciplines. Discourse analysis has been variously developed within linguistics as well as within other social science disciplines (Fairclough, 1992). One such development was critical discourse analysis. Accounting researchers have also begun to employ discourse analysis in their research studies and a special issue of the *Accounting, Auditing and Accountability Journal* on "Accounting as Codified Discourse" was published in 2007 (see, for example, Ferguson, 2007; Gallhofer et al., 2007; Spence, 2007).

version of critical discourse analysis is most prominent in research studies, has stressed that critical discourse analysis is thus a mode of research as well as a weapon in social struggle (Fairclough, 1993, p. 134; Gallhofer et al.,2001, p. 123). It is especially this reference to praxis that has attracted critical theoretical researchers to critical discourse analysis. Below a brief summary of Fairclough's critical discourse analysis is offered and an elaboration of how critical discourse analysis has been applied in this study here.

Critical discourse analysis is a complex method involving various levels of analysis, including the linguistic dimensions of a discourse as well as its socio-economic dimensions. Fairclough developed a three-dimensional framework for the analysis of discourse in which he identified the following levels: level one, discourse as text; level two, discourse as discursive practice; and, level three, discourse as social practice (Fairclough, 1993; Blommaert and Bulcan, 2000; Gallhofer et al., 2001). Level one focuses on the linguistic features of texts; level two on the processes by which texts are produced, distributed and consumed; and, level three understands discourse as a social practice and considers how discourse impacts on its context, including the well-being of people and how it is shaped by the context (Gallhofer et al., 2001, p. 125).

It is of interest that although Fairclough developed this very complex model of analysis he does not suggest that this model should always be replicated in research studies using critical discourse analysis. On the contrary, as Gallhofer et al. (2001,

p. 122) point out, 'Fairclough stresses that the research question and focus influence how one does critical discourse analysis in that the researcher emphasises differing aspects and dimensions of the analysis' (see also Gallhofer et al., 2007). This study here uses critical discourse analysis as advocated by Fairclough, that is, it mainly focuses on level three of the model, that is, discourse as social practice. Focusing on this level facilitates analysis of the documents issued during the bilateral trade negotiations between Japan and the U.S. and the process of developing the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* as embedded in their socio-economic, political, cultural and historical context. Further, analysis at level three draws attention to the way in which unequal power relations between participants in debates may affect the outcome of debates, and, how these debates and outcomes reflect and impact upon particular cultures. And, attention is drawn to the sense in which these debates can shape the way of life of people and affect their well-being. These areas that are considered at level three of critical discourse analysis are also especially of interest to this study here. Chapter 7 and Chapter 8 thus provide an analysis of the documents issued during the bilateral trade negotiations between Japan and the U.S. and the process of developing the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* by employing a critical interpretive textual analysis, which is informed by level three of Fairclough's critical discourse analysis.

4.4. SUMMARY

Chapter four has provided some methodological considerations and outlined the research process applied in this study. It elaborated the way in which theoretical position, research design and method are interrelated and offered a brief elaboration of ontological and epistemological assumptions. It provided a rationale for and outline of the particular case study methodology adopted in this study. The chapter also summarised the methods applied in the empirical analysis of the study, namely content analysis and critical interpretive textual analysis and provided a rationale and brief overview of the sample of newspapers analysed in this study. The next chapter, chapter 5, provides a brief history of socio-economic developments in the Japanese context from the mid-nineteenth century to the early twenty-first century. In the context of this historical overview reference is also made to developments in the Japanese corporate system and the Japanese corporate governance system.

CHAPTER 5

INSIGHTS INTO THE HISTORY OF JAPAN AND THE DEVELOPMENT OF JAPANESE CORPORATE GOVERNANCE

As chapter two has argued, corporate governance systems are embedded in a particular socio-economic, political, cultural and legal context and analyses of corporate governance practices need to take into account characteristics of this context and its interrelationship with the relevant corporate governance system. Further, adopting a historical perspective in the analysis of the context and the corporate governance system embedded in it facilitates understanding of how current features of corporate governance systems have developed and an appreciation of the presence of any issues and tensions concerning these corporate governance systems today. This means that in order to understand recent and current debates about corporate governance in Japan it is important to gain an historical appreciation of the Japanese context and the specific Japanese corporate governance system. This chapter therefore offers a summary of key developments in the history of Japan and the Japanese corporate governance system. The emphasis in the chapter is on contextual developments that were especially important for the emergence of the specific characteristics of the Japanese corporate governance system. The chapter covers the period from 1868 until 2007, a period that witnessed Japan's development from a feudal economy to the second largest capitalistic economy in the late 1970s, a period of crisis from the 1990s and a recovery period beginning in 2005. During this period Japan went through significant changes in its socio-economic, political and cultural spheres and the corporate governance system embedded in this context. The discussion of the historical context here is selective and highlights significant developments especially in the economic and political spheres that had a significant influence on the development of the Japanese corporate governance system. In the discussion of the historical developments, emphasis is also placed on developments and changes in the Japanese corporate system due to the close interrelationship of the corporate system and the corporate governance system. The historical period covered here is divided into four sub-periods:[33] sub-period one covers developments from 1867 to 1937, the beginning of the Meiji Restoration and a time during which major steps towards Westernisation and industrialisation were taking place; the second sub-period from 1937 to 1945 is characterised by Japan's war efforts; the third period from 1945 to 1989 covers the rebuilding of Japan after the end of World War II and its economic growth during the 1970s and 1980s, which saw Japan emerge as a major economic force globally; and, the fourth sub-period from 1990 to 2007 outlines how Japan went into crisis after the bursting of its bubble economy and its subsequent road to recovery .

5.1. 1868 TO 1937: JAPAN BECOMES A MODERN CAPITALISTIC STATE

After 1868 Japan went through a major transformation that replaced a feudal state and economy with a modern capitalistic state and industrial capitalistic economy.

[33] This periodisation has been chosen as it emphasises especially economic and political developments in the history of Japan.

Westney (1987, p. 1) points to the significance of these transformations in the socio-economic, political and cultural spheres:

> To many Westerners who came to Asia in the 1860s, arriving in Japan seemed to be stepping back centuries in time, into a world of sword-wielding knights, subservient peasants, tradition-bound merchant guilds, and haughty feudal lords. But within a few years of the Meiji Restoration of 1868, the Japanese adopted a wide range of new institutions and manufacturing and information technologies from the West in a massive effort to reshape Japan into a nation that would be equal to the Western power. Westerners watched with interest and no little amusements as the emulation of Western culture and institutions began to transform the society.

The feudal system that Westney (*ibid.*) is referring to had already been established in 1192 when Minamoto no Yoritomo, the leader of the Bushi warriors, was authorised to open the first feudal government (*bakufu*) in Kamakura, East of Japan. Although the emperor still remained as the Head of State in Kyoto, the old capital of Japan, Minamoto no Yoritomo (Seii Taishō gun) was the *de facto* ruler of Japan. Feudal governments changed over the following centuries because of wars between various feudal lords. It was one of these wars at the turn of the sixteenth to the seventeenth century that significantly impacted upon the power structure of Japan. This war ended with the victory of Tokugawa Ieyasu over the Toyotomi family. As a consequence of this victory, Tokugawa Ieyasu took over as Shogun in 1603 and the Tokugawa family held power in the feudal government until 1868. The characteristics of the Tokugawa reign were its seclusion policy, which isolated Japan from outside influence, and a related peaceful period of over 210 years, in which education and culture were further developed in Japan.

Since the 1630s, Japan had operated a closed country policy (*sakoku*). Cullen (2003, p. 48) explains that *sakoku* (national exclusion) is a modern term that refers to a policy applied from the 1630s to the 1850s whereby Japanese ports were closed to almost all vessels (exceptions being a limited number of Dutch and Chinese vessels) and travel abroad was forbidden. Such a closure to influences from the outside world was achieved through the issuance of five principal decrees between 1633 and 1639. These decrees forbade, as Jansen (2000, pp. 78-79) explains, Japanese who had travelled abroad to come back to Japan and ships to be sent to destinations outside Japan. It elaborated prohibitions on missionaries and Japanese Christians and stipulated that all ships should be sent to one port of entry, Nagasaki. Further, Dutch settlers in Japan were forced to move to a small artificial strip of land in Nagasaki, located in the West of Japan in 1641. In the literature, common reasons given for such an exclusion policy were a fear of Christianity and a concern that Japanese dissidents would align themselves with outside forces (see, for example, Beasley, 1990, p. 22). Cullen (2003, p. 49) makes the point that 'fear of Christianity was a form of shorthand for an omnibus fear about Western intentions'. Although there are several explanations provided in the literature on when this policy was completed, it is reasonable to conclude that the removal of the Dutch settlers completed the seclusion policy (Miyamoto, 1973; Hanawa, 1983). Under this policy, only Chinese and Dutch merchants were allowed to come to and trade with Japan. This seclusion policy gave rise to events in the 1850s (see below) that led to the overthrow of the Tokugawa reign and the end of feudalism in Japan.

The other feature of the Tokugawa reign that significantly shaped Japan's development, was a peaceful period of over two hundred years (Cullen, 2003).As Japan enjoyed notable peace and a politically stable period, an important change in social roles took place. *Bushi* warriors[34] began to function as policy makers and administrative officers rather than warriors. As a consequence of this change in their roles they became more concerned about learning and art than warfare and increasingly sent their children to school. During the peaceful period many schools were thus established. Those established by the *Daimyō* (feudal lord) were called *Han-kou* and private schools were called *Terakoya.* In these schools children were taught by, for example, Buddhist priests, Shinto priests, medical doctors and masterless samurai (Komiyama, 2006). Sons of Bushi warriors were educated in *Han-kou* and children of other classes went to *Terakoya.* Nish (1968, p. 70) points out that in the eighteenth century many *Terakoya* were established: 'They are estimated to have numbered 15,000; and, if this figure is accurate, the rate of literacy in Tokugawa Japan was higher than that of Europe at the time.' He further points out that '[t]he provision of this basic education paved the way for the remarkable educational and political achievements of the later nineteenth century' (see also Allen, 1981, pp. 2-3). Historians have argued that the rate of education facilitated the modernisation and industrialisation of Japan in the Meiji period. As Allen (1981, p. 3) observes:

> Japan assimilated new techniques and habits of thought with ease because her population was literate and well-trained technically. But it must not be

34 *Bushi* were the warrior class, also called *samurai*, in Japanese society. Since the twelfth century they had political power in Japan (Davies and Ikeno, 2002, p. 41).

> thought that her educational achievements can be attributed solely to her success in following Western models. Her leaders brought with them into the new era a system of values based on the intellectual and moral discipline of the past, and the career of Japan owed much to this inheritance...while the Japanese were able to free their minds from that part of their Confucian legacy that was in practice hostile to technological change, they carried into the new world traditional codes of conduct and habits of mind which served the cause of national power and economic progress. These codes and habits affected the relations between superior and inferior and the mutual obligations of those in authority and those subject to it. They reinforced the sentiments of patriotism and family and group loyalty. They encouraged frugality and assiduity. The outstanding business leaders, while active in pursuit of their own ambitions, seldom lost sight of national purposes.

In the mid-1850s, however, this peaceful period came to an end. It has been argued that the pressure from outside Japan encouraged developments that led to the end of the Tokugawa feudal government and the beginning of the Meiji restoration, which was ‘a concerted modernisation effort by thoroughly reshaping social and political structures and giving the people at large a new sense of national self-identity’ (Hirschmeier and Yiu, 1975, p. 70). U.S. warships under the command of Admiral Perry came to Japan and delivered a personal letter from their President in 1853. Japan was asked to abandon its isolation policy because the U.S. at that time needed ports to supply fuel and water for their whaling ships. Not having been able to achieve this goal on his visit, Perry again went to Japan in the following year and this time pressurised Japan to sign the treaty. The feudal government of the time yielded to the foreign power in the light of its military power and signed the Treaty of Peace and Amity (*Nichibei Washin Jōyaku*) in 1854. The Tokugawa government opened two sea ports, Shimoda and Hakodate, by treaty with the U.S. Ironically, this event resulted in weakening the power of the Tokugawa government. The Tokugawa government and its subordinates who had monopolized power over other feudal lords had made this key policy decision on their own without consulting with the other feudal lords and the Emperor. This action was heavily criticised.

The significance of the treaty was that it brought to an end the Tokugawa government's policy of isolation and opened the country to foreign trade and influence. As a reaction to the treaty, which was seen as a threat to Japan more generally, a boycott movement against foreign rice emerged. At the same time, influenced by *Kokugaku* (the study of Japanese literature, thought and culture, called 'national learning'; Beasley, 2000, p. 19), which had become strong during the Edo era the campaign of Advocacy of the Restoration of the Imperial Rule (*Sonnō Shisou*) gained momentum. The slogan, which became popular during this period was *Sonnō-jōi Undo* ('Revere the Heavenly Sovereign, Expel the Barbarians'; McClain, 2002, p. 140) and became closely linked to *Sonnō Shisou.* The main players of this movement were discontented lower-level bushi warriors who had become administrative officials during the peaceful period but had not had any possibility to socially advance because of their fixed hereditary status in the feudal social system. This movement put Japan in an unstable political situation (McClain, 2002).

The political situation further worsened when the U.S. minister in Japan, Townsend Harris, received orders to enter into a peace and trade treaty with Japan. He tried to persuade the Japanese government by pointing to threats to Japan from other

European countries. *Rōjyu* (senior councillor) Hotta Masayoshi told Harris to wait until imperial sanction was given to complete the treaty. Hotta went to Kyoto, where the emperor's palace was, but the emperor sent the petition back to the government and ordered that talks were held with other feudal lords on this matter. Hotta resigned and Ii Naosuke was appointed *Tairo* (chief councillor), which was a temporary position and above *Rojyu* (senior councillor). Ii concluded *Nichibei shūkou tsūshou jouyaku* (the Japan-US Friendship and Trade Treaty) with the U.S. without imperial sanction in 1858. Abiding to the treaty, the government opened three further sea ports: Kanagawa (Yokohama), Niigata and Hyougo (Kobe). This treaty was much criticised as it was seen as an unequal treaty because Japan did not have tariff autonomy, gave America consular jurisdiction rights and treated the U.S. as the most favoured nation. Soon after the government had signed the treaty with the U.S., treaties of the same kind were signed by Japan with the Dutch, France, Russia and the United Kingdom (Beasley, 2000, pp. 31-34). The signing of these treaties and their content exasperated those who were opposed to opening the country and sought to expel foreigners. In addition, Emperor Koumei also wished to close the country. Concerned about the growing movement, Ii brought pressure on the opposition, which came to manifest in what was called *Ansei no Taigoku* (the Ansei Purge). Cullen (2003) remarks that in the context of the Ansei Purge 'seventy-nine persons were detained, seven of whom were executed. More important than the numbers was of course the status of some of those punished' (p.184). It has been argued that behind this purge there was a conflict between those who aimed to advance the union of the Imperial Court and the Shogunate and the cooperation with other daimyo, and those who claimed that the government should govern the country as it had done in the past, that is, without cooperation and consultation. On 3 March 1868, as a reaction to the oppression, Ii Naosuke was assassinated outside of Edo castle by *roushi* (master-less samurai) who had been exasperated by his policy. This incident further damaged the credibility of the government (Beasley, 2000). The political instability was further fuelled by events that had occurred as a consequence of opening the country in the 1850s and the conditions of the subsequent treaties. For example, the opening of Japan to the West brought about a rise in prices and intensified the movement against the feudal system in Japan. Further, as a consequence of the opening of sea ports, production centres and sea ports were now directly connected. This resulted in a change in the distribution system thus undermining the conventional system, which was monopolized by privileged merchants (Beasley, 2000; McCullen, 2003).

In addition to the above changes in the socio-economic sphere, significant developments also took place in the political sphere. In response to a request from emperor Koumei, the government sought to advance the union of the Imperial Court and the Shogunate policy and to build a cooperative relationship with other daimyo. Some potent daimyo such as, for example, Satsuma, Chōshu and Tosa were especially enthusiastic about engaging in politics. It has been argued that the emperor and other potent daimyo did not intend to defeat the government. *Sonnō-joui Undo* (the campaign to restore the emperor to power and expel the barbarians) in the light of the above developments changed its direction and turned into an anti-

Shogunate movement. Goto Shōjirou from Tosa persuaded Tokugawa Yoshinobu, the last shogun of the Tokugawa government, to return political power to the Imperial Court. Tokugawa Yoshinobu, recognising his unattainable position, returned the political power to the Imperial Court on 9 November 1867 (Bailey, 2000, p. 52). Notwithstanding Tokugawa government's compliant submission, some clansmen from Satsuma and Chōshu who controlled the feudal domains succeeded to issue an imperial ordinance to conquer the Tokugawa government. Furthermore they ordered Tokugawa Yoshinobu to return his court rank and domain. This order infuriated his royal vassals, Aizu and Kuwana. Mobilising the former governmental army, Aizu and Kuwana engaged in hostilities with the new governmental army. The battle between the former governmental army and the new governmental army continued until 1869 (*ibid.*, p. 53). Hereafter Japan entered a new phase in her history and her urgent issue was to build a modern and centrally administered state. In pursuing its policy of establishing a modern and rich Japanese state with a strong army and in an attempt to catch up with developed Western countries such as Britain, France and Germany, the government centralised the administrative power in Japan. Japan also adopted capitalism and democracy, although universal suffrage was only granted in 1945 (Jansen, 2000, p. 677; Okumura, 2004). In the following, the developments that led to the modern centralised state and a form of capitalistic economy in Japan are outlined in more detail and reference is also made to developments that were particularly important for the emergence of the Japanese corporate governance system.

It has been argued that the motivation to overthrow the Shogunate was to avoid being colonised by Western countries and to restore power to the emperor. In 1868 the emperor expressed the new government's basic policy, which is known as *Gokajyō no Goseimon* (the Imperial Covenant Consisting of Five Articles). Keene (2009) translated this document into English:

Oath in Five Articles

- Deliberate assemblies shall be widely established and all matters decided by public discussion.
- All classes, high and low, shall unite in vigorously carrying out the administration of affairs of state.
- The common people, no less than the civil and military officials, shall each be allowed to pursue his own calling so that there may be no discontent.
- Evil customs of the past shall be broken off and everything based on the just laws of nature.
- Knowledge shall be sought throughout the world so as to strengthen the foundations of imperial rule (Keene, 2009).

Once power had been restored to the emperor, the governing structure was altered. At the beginning of this era, the governing structure consisted of a direct administration by the emperor and three officials, *Sousai* (Governor), *Gijyo*[35] and *Sanyo* (Councillor), who supported the emperor (Sakamoto, 1999). Soon after proclaiming the Covenant, this structure was replaced when the new government issued *Seitaisho* (the Organic Act of 1868). McClain (2002, pp.157) summarises this document as follows:

[35] No translation for this term could be found in the literature.

> ...the Seitaisho, sometimes referred to as the Constitution of 1868...vested all authority in the Dajokan, or Grand Council of State. First established as part of the reforms of the seventh and early eighth centuries that brought the Japanese state into existence, the Dajokan served as the chief policy-making and administrative organ of Japan's early imperial state before waning in significance. As revived in 1868, the Dajokan was headed by a grand minister of state, two vice-ministers, and several councillors who presided over various bureaus.

This system was kept until December 1885 when the Grand Council of State (Dajōkan) was replaced by a European type cabinet (*Naikaku*) (Beasley 2000, p. 68).

A significant challenge for the new government after 1868 was the need to replace the old feudal structures with a new administrative system that would take power away from the still existing feudal lords. This was especially important as the government needed to raise taxes and aimed to build up a national army in the light of perceived threats from outside as well as inside. Between 1868 and 1871 various attempts were made to initially restrict the power of the domains before finally dismantling them. The domain structure ended on 29 August 1871 when it was replaced by a new administrative structure. Under this structure the country was divided into administrative districts called 'prefectures'. These prefectures were the first step towards a centralised state (Beasley 2000, pp. 60-1).

Having replaced the old feudal structures, the new government turned towards revising the unequal treaty, which the Tokugawa government had concluded with the foreign countries in the closing days of the Tokugawa era (Kimura 1981) and to further push forward the industrialisation of Japan. To achieve both objectives the new government thought it important to modernize the country and to set up various social infrastructures, such as, for example, a Western legal system, a national railway system, a national postal system and a national army. The government therefore pushed ahead with *Fukoku Kyōhei* (wealth and military strength) and *Shokusan Kougyō* (the promotion of industry) (Nakamura, 2003). Japan adopted the idea or pursuit of capitalism and democracy and Western technology. Developments until around the turn of the century were State led, with the government exercising leadership in the political and economic development of Japan. The main objective was to modernise, which meant to Westernise, the political and economic structures of the country. In order to achieve Westernisation, delegations were dispatched to the U.S. and European countries to learn from these countries and to observe their practices. Within a short period, significant changes had taken place in Japan. The political system, which had been modelled on the Chinese system, was replaced by a system modelled on European sources. A modern constitution was promulgated in 1889, the *Diet* was established in 1892 and the Code of Civil Procedures and the *Commercial Code* were introduced in 1890 and 1899 respectively (McKinnon, 1986, pp. 123-128). The introduction of a modern legal structure was important for two reasons: first, it constituted a legal framework, which was acceptable to Western countries and was thus necessary in the context of Japan's attempts to achieve a revision of the unequal treaties (McKinnon, 1986, p. 125); and, second, it provided the legal framework for a speedy and initially state-led industrialisation. The government was successful in implementing a modern and Western legal system into Japan. Having introduced a constitution and five major codes by the end of the century it achieved the revision of the unequal treaties as the Western nations accepted its new legal system (McKinnon, 1986, p. 128). In the context of its modernisation project the government also modernised the army, which was modelled on Germany and France and introduced a national postal system (Beasley, 2000).

As stated above, the government's political and economic policy was *Shokusan Kougyō* (the promotion of industry). This policy was advanced by Okubo Toshimichi, who was an attendant of the *Iwakura Mission*, which visited the U.S. and other European countries with the purpose of studying Western systems. Okubo created the *Ministry of Home Affairs* (*Naimushou*) and took office as the Minister of the newly created Ministry because of the experiences he had gained from his visit to European countries. He also pushed forward *Shokusan Kougyō*. Sakamoto (1999) argues that Ōkubo put forward this policy under government initiative. In order to facilitate *Shokusan Kougyō,* Ōkubo set up *Koubushou* (a Ministry charged with the managing of the process of achieving this policy) in 1870. This Ministry was subsequently replaced by *Naimushou* (the Ministry of Home Affairs), which was established in 1873. The Meiji government preceded with industrialisation by first setting up government enterprises in areas such as, for example, creation of a railway network, iron industry, shipbuilding and silk reeling. The government selected a small number of business people who were called *seishō* (businessman who had connections with the government) who received certain privileges. For example, *Seishō* were able to rent ships from the government free of charge for their trading ventures. When the government sold off part of the state-owned companies, *Seishō* were offered these companies for purchase (see below) (Sakamoto, *ibid*).

One aim of the state-led growth during the early Meiji period (up to 1900) had been to strengthen Japan's military power and the other to promote new industries (Teranashi, 2000, pp. 43-44).[36] In both cases the government had been successful. When Japan engaged in war with China (First Sino-Japanese War, 1894-1895) and a decade later with Russia (Russo-Japanese War, 1904-1905), the enemy was defeated in both cases (Perez, 1998, pp. 117-124). In terms of economic development the government's attempt to industrialise Japan had also been successful.

It is of note that World War I had a different impact on Japan and its people than it had on the European states and their people. Of significance for Japan was the creation of a large European market for war exports that Japan was able to take advantage of. This in turn further facilitated Japan's industrialisation (Totman, 2000, p. 361).[37] Thus, during the 1920s the Japanese economy experienced

[36] There are different interpretations in terms of the role that the Japanese state played in leading the development of Japan. Interpretations vary between the state 'as a dominant and enlightened force in promoting Japan's modernization and the population as a pliant yet capable mass able to be guided toward modern ways' and an emphasis on the 'state's repression of the popular will in the course of enacting its social revolution from above' (Jones and Ericson, 2007, p. 173).

[37] Totman (2000, p. 361) points out that a significant impact of World War I on Japan was that it changed the geopolitical context of the region: 'By crippling the European capacity to shape affairs in East and Southeast Asia, it created new geopolitical uncertainties and opportunities...In short, the war

significant economic growth and an expansion of national and international markets (Perez, 1998, p. 137). Economic growth was also further facilitated through the enhancement of the transportation and communication system and free trade policies. Teranishi (2000, p. 45) refers to key characteristics of the economic system during the Taisho era, which had facilitated economic growth, for example, the free competition principle, private sector-led economy and an emphasis on the regional economy. This period has been referred to as the 'era of Taishō Democracy' but Perez (1998, p. 137) argues that 'this era can also be characterized as the period when Japan moved away from democracy toward military adventurism' because of the less influential role of government during this period. Totman (2000, p. 362) comments on the changed role of the government from the end of the Meiji era (1912) up to the end of the 1930s:

> ...for most of the post-1914 period, one is struck by the modesty of governmental effectiveness in domestic affairs, in contrast to early Meiji, when government initiative was central to so much socioeconomic change...[I]n post-Meiji Japan government played an increasingly marginal and erratic role in shaping social, economic and cultural developments...Even in foreign affairs its role was inconsistent and indecisive...

Towards the end of the period the military became more powerful in the context of a perceived threat from Russia (Perez, 1998, pp. 138-9). The influence of the military led to Japan embarking on another war with China in 1937. Having outlined key developments in the socioeconomic, political and cultural context of Japan during the period from 1868 to 1937 the next section provides a summary of

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ended the era of a relatively stable East Asian context, ushered in one of much greater instability, and deepened Japanese involvement in that new era'.

key developments in the corporate sector of Japan during this period, which were of significance for the development of the Japanese corporate governance system.

During the period from 1868 to 1937 several developments took place in the political, economic and legal spheres that had a significant impact on the organizational, ownership and financing structures of business organisations and management practices and that were significant for the development of the Japanese corporate governance system. We thus now turn to a discussion of developments during this process of modernisation and Westernisation that are of particular relevance for an understanding of how the Japanese corporate governance system developed: the introduction of the *Commercial Code*, the growth of the *zaibatsu* and the Japanese style joint stock company, Japanese employment practices and the development of the Japanese banking system.

5.1.1. The Introduction of the Commercial Code

As referred to above, in its attempt to Westernise and industrialise, Japan's government introduced a modern legal framework, which was modelled on Western practices. For corporate governance and businesses more generally key developments took place in the 1890s. A Company Law was introduced in 1893 that provided for the setting up of three types of companies: the joint stock company (*kabushiki kaisha*), the limited partnership (*gōshi kaisha*) and the unlimited partnership (*gomei kaisha*) (Hirschmeier and Yui, 1975, p. 187). The development and introduction of the *Commercial Code* in Japan in the 1890s, as McKinnon (1986, p. 126) has pointed out, was bound up with a dispute between English and French-trained Japanese jurists. The *Commercial Code* as well as the Civil Code were originally drafted by French-trained jurists. The English-trained lawyers held up the introduction of the Codes as they were concerned about an overemphasis of French law in the drafts. In contrast, the French-trained lawyers held that their drafts were based on principles 'universally applicable to mankind' (Takayanagi, 1963, pp. 30-32, cited in McKinnon, 1986, p. 126). In the early 1890s advances were made when the government commissioned Herman Roesler, a German lawyer, to draft a *Commercial Code* for Japan. Roesler's draft was based on the then draft German *Commercial Code*. When Japanese jurists raised objections against the draft *Commercial Code* the government asked them to re-work the Code. McKinnon (1986, p. 119) explains that the re-worked version of the *Commercial Code*, however, 'differed very little in substance from Roesler's original draft' as the Japanese lawyers in the process of re-working the draft Code had begun to appreciate German law. McKinnon (1986, p. 120) has summarised the significance of the introduction of the *Commercial Code* as follows: 'With the Introduction of the Code, the Japanese system of regulation assumed its initial structural form, comprising a single authority, the Ministry of Justice, utilizing a single mechanism of regulation, the Commercial Code.' The *Commercial Code* was the basis for the corporate form of business organisation and the regulation of its financial disclosure.

The *Commercial Code* introduced in 1899 consisted of five books: General Provisions (Book I), Companies and Partnerships (Book II), Commercial Acts (Book III), Bills (IV), and Maritime Commerce (V). Legal requirements for the formation and liquidation of joint stock companies, the rights and duties of the directors, shareholder and the annual general meeting and disclosure requirements (McKinnon, 1986, p. 123) were contained in Book II. Over the years the Japanese *Commercial Code* went through several revisions with the latest and most significant one being completed in 2006: through the last revision, Book II of the *Commercial Code* was integrated into Company Law. The Japanese Corporate Code still exists but it has ceased to cover joint stock companies.

5.1.2. The Development of the **Zaibatzu** *and Japanese Style Joint Stock Companies*

From the beginning of the Meiji Restoration, two different kinds of joint-stock company took prominence in Japan: the type of joint-stock company known in the West and the *zaibatsu*, a form of joint-stock company peculiar to Japan. A significant number of *zaibatsu* had emerged in a context where the government began to sell off some of the companies that it had initially established in order to push forward industrialisation in Japan. Through the sale of such companies, the government aimed to raise some capital. State-owned companies were sold in many cases to those businessmen who had good connections to the government or government agencies (*seishō*, see above). Through acquiring these companies some businessmen were able to form *zaibatsu*. Many *zaibatsu* maintained close links with the government (Bailey, 2000, p. 117).

Zaibatsu were 'large, diversified conglomerates' (Yafeh, 2000, p. 75) owned by the founders and their families. Yamamura (1964, pp. 539-540) summarises the key characteristics of a *zaibatsu* as follows:

(a) Semi-feudal characteristics, in that centralized power rests in a Zaibatsu family, which extends its power through strategically arranged marriages and other personal knight-vassal dedication relationships.

(b) Well-knit, tightly controlled relationships among the affiliated firms by means of holding companies, interlocking directorships, and mutual stockholdings.

(c) Extremely large financial power in the form of commercial credit which is used as the central leverage to extend control in all industries.

Especially after the issuance of the Company Law of 1893, *zaibatsu* controlled their affiliated enterprises through holding companies, which were non public enterprises and controlled by their founders and their respective families (Tanaka, 1998). The structure of a *zaibatsu* was a corporate pyramid with the holding company at the top of the structure and a series of joint stock companies attached to them and controlled by the former (Hirschmeier and Yui, 1975, p. 187). Despite their size there was considerable concentration of ownership in *zaibatsu*. The reason for this was the method of internal financing through the establishment of their own financial institutions (*ibid*., pp. 186-187).[38] With the expansion of the *zaibatsu* and the introduction of graduates as professional managers, these

[38] This is in contrast to development in the US 'where owner-management gave way to the corporation with diffused ownership and management by career executives' (Hirschmeier and Yui, 1975, p. 186).

organisations,[39] according to Hirschmeier and Yui (1975, p. 187), faced the following problem:

> The most urgent task of the *zaibatsu* leaders was then, after 1900, to create new structures of control which would give maximum flexibility while maintaining firm central control and undivided ownership.

Based on the Company Law many important *zaibatsu* re-organised their company structure with 'holding companies in the centre and a string of joint stock companies controlled by the former' (Hirschmeier and Yui 1975, p. 187).

According to Cooke and Sawa (1998, p. 218), ten main *zaibatsu* had become prominent during 1867 to 1937. Out of the ten *zaibatsu* two had been founded during the period of the last feudal government and the others between 1867 and 1912. Their economic power had been further enhanced through investments in banking, mining and foreign trade. In the period before the Second World War, these *zaibatsu* controlled a significant part of the commercial and industrial activities of Japan (Teranishi, 2000, p. 46; Yafeh, 2000, p. 75). According to Beasley (2000, pp.116-117), the 'Big Five (Mitsui, Mitsubishi, Yasuda, Sumitomo, and Daiichi), together capitalized at fifty million yen in 1914 and 280 million in 1927, controlled 19 per cent of private banking by the end of the period.' Mitsubishi's formation during this period is typical of a *zaibatsu*. Mitsubishi was formed during the Meiji era. The founder of Mitsubishi, Iwasaki Yataro, originated

[39] Allinson (1999, p. 42) explains: 'As rationally managed business organizations, the zaibatsu set the standard for other firms to follow. They were among the first Japanese firms to ire college-educated, professional managers to oversee individual firms and eventually to take leadership positions of their holding companies.'

from a low grade *bushi* warrior. He had worked for a trading firm run by the feudal domain West of Japan, which had played an important part in overthrowing the Tokugawa government. When the new government banned the practice of companies being run by feudal domains, Iwasaki Yataro took over the trading firm. Iwasaki, who was engaged in maritime transport, was able to extend his business through cooperating with the government in its battle with rebellions supporting the old order. After the death of Iwasaki Yataro his brother Iwasaki Yanosuke succeeded in the business (Abe, 1995, pp.101-103). Subsequently Mitsubishi diversified into other sectors, such as, for example, shipbuilding, mining, heavy industry and foreign trade. They also established a bank in 1880 (Beasley, 2000, p. 117; see also Hirschmeier and Yui, 1975, pp. 138-142).

In contrast to the *zaibatsu*, ordinary joint-stock companies were listed and owned by general shareholders. The Japanese joint stock companies differed in terms of ownership and control from Western companies as the separation of ownership and control was not carried out to the same extent. In terms of the development of corporate governance, it is of interest that, as Teranishi (2000, p. 45) has pointed out, from 1900 to 1920 'the separation of ownership and control was still in its initial step, and firms were controlled by large stockholders' According to Hirschmeier and Yui (1975, pp. 188-189), 'the structure of the executive officers developed in Japanese companies somewhat along different lines from those common in the West...the most important difference...probably [being] the combination or fusion between the actual managing positions and those of control'.

In practice this meant that the main shareholder, or a representative of them, would hold the position of president[40] as well as being the chairman of the board of directors and the shareholders' assembly. In the context of low numbers of shareholders this was not necessarily a problem for other shareholders as the president was also able to represent their interests. As career executives became more involved in management, however, this situation changed. Executive directors took on the roles of decision-maker and key administrator, reducing the role of the shareholder president to one of figure-head who would represent the company to the outside world. It is of note that since the early twentieth century the executive director usually had joined the company as a university graduate and had risen within the company to this position (Hirschmeier and Yui, 1975, pp. 188-189). Of significance here is that very soon these newly established executive directors had become major shareholders themselves through investing their high salaries in their own companies (*ibid.*, p. 196; Miyamoto, 2005).[41] Non-executive members of the board of directors were elected shareholder representatives.

5.1.3. The Development of the Japanese Employment System

Factories during the early industrialisation stage in Japan found it difficult to employ and retain skilled workers. In addition to the low wages paid, Hirschmeier and Yui (1975, p.117) point out that another important reason for this was the

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40 This was also the case for *zaibatsu* (*supra*).

41 Further, shareholders who had an interest in a particular company would buy shares from other shareholders in order to take over the company, a phenomenon particularly common in the spinning industry (Miyamoto, 2005).

'popular belief that factory work was an evil to which they preferred much lower paid home employment.' Hayashi (1979) explains that in this context employers mobilized their personal relationships in the places they came from to hire skilled crafts-men or employed members of their kinship groups (p.21). The low wage rate of these workers was supplemented by the wages of the wives and children who were also employed by the factories or companies. Such a system is referred to in the literature as 'total employment system or whole-family employment system' (*ibid*). In the context of such employment practices a unique relationship between employer and employee developed in companies in Japan, namely the 'the quasi-family-type or affectionate relationship' (*ibid.*). Despite the quasi-family-type relationship there was, however, a high turnover rate in the factories. The main reason for this was that the crafts-men tried to improve their skills by obtaining training in different factories (Hayashi, 1979, p.22).

It is of interest that in the case of unskilled workers the relationship between employers and employees was different from that of crafts-men. As Hayashi (1979, p.22) explains:

> ... in this case [the relationship] was rather that of patron and clients, with the employer providing not only foods, clothes, and shelter but also necessary expenditures in connection with social functions in addition to bonus payment twice a year.

Hayashi (1979, p. 22) maintains that some of the characteristics of the particular employer – employee relationships that developed in Japan during the 1880s and 1890s are still evident in Japanese employment relationships today.

Another practice aimed at attracting workers during this period was to send recruitment agents to other companies and to poach their employees. In the context of the recruitment and retention problem that companies experienced two key positions emerged in relation to how these issues could be resolved: There was the view that competitive and stable wages should be introduced. This argument was made by employers who believed in the market principle. The majority of the employers, however, did not want to change the traditional relationship between employer and employee. Hirschmeier and Yui (1975, p. 119) hold that "most employers emphatically rejected this kind of reasoning, declaring that employer-labourer relationships ought to be guided by the time-honoured father-son principles, and that monetary motives, and the ideas of rights legally defined, should not be permitted to spoil this relationship." The crisis in employment and management that arose towards the end of the nineteenth century was successfully overcome during the 1920s and 1930s when permanent employment and seniority based pay, two characteristics of what is known today as the Japanese employment system or Japanese labour relations, were introduced (Hirschmeier and Yui, 1975, p.119; Hayashi, 1979, p. 23; Beasley, 2000, p. 119). It should be pointed out, however, these employment practices only benefited part of the Japanese labour force. As Beasley (2000, p. 119) explains:

> It applied to the major high-technology industries, spreading outwards, it would seem, from shipbuilding and the engineering trades, though even in those fields it benefited only part of the labour force. Unskilled and semi-skilled workers, who had no scarcity value, lacked the bargaining power to insist on comparable advantages, no matter who employed them. In other

words, what was emerging was an elite among workers, similar to the one which the *zaibatsu* and a few other concerns comprised in the business world at large.

5.1.4. The Development of the Japanese Main Bank System

Further, this period saw the emergence of the Japanese banking system. The developments during this period were also significant for the emergence of the Japanese main bank system, which is a key component of the Japanese corporate sytem. Main banks are not only the providers of finance for Japanese companies but also have an important monitoring role in the Japanese corporate governance system. Hidaka and Kikkawa (2004) outline the key features of a main bank as follows:

> 'Main bank' is originally a term used by practitioners in Japanese financial institutions and industrial firms. They call a particular bank the main bank when the firm obtains its largest share of borrowings from that institution. It also holds a certain amount of equity in the firm (Hidaka and Kikkawa, 2004).

From the 1870s to the 1910s a modern financial system was created in Japan. In this context the banking system evolved out of a process whereby elements from various foreign banking systems were combined and adapted so as to form the Japanese banking system. According to Aoki (1994), the following banking systems had an impact on the Japanese banking system:

> The Japanese system combined elements of the Anglo-American commercial banking system, composed of national banks (*kokuritsu ginko*) authorized to issue bank notes with national bonds as

> collateral, and later ordinary banks (*futsu ginko*) funded by private capital, with the continental European model of long-term credit banks for industry and agriculture...as well as local savings banks and postal savings. Japan established a central bank in 1882 based on the Belgian example...(Aoki, 1994, p. 43).

Banks became the major provider of external finance for companies during this period. A decentralised banking system with two types of banks had emerged by the 1920s: first, five large z*aibatsu* banks, and, second, a large number of medium and small banks. Aoki (1994) describes these banks as follows:

> [They] were closely connected to a particular group of industrial firms by credit relations and (cross) ownership. Some of the small banks were family owned...and often closely tied to their own firms. In providing long-long term investment funds, those banks took a different development route from the British commercial banks (Aoki, 1994, p. 43).

Of interest here is the development of the *Kikan-ginko* system, whereby industrialists established banks in order to finance their activities. These banks were closely linked to their affiliated firms through close cross-directorships (Teranashi, 2000, p. 45). After a banking crisis in 1927 the number of banks was significantly reduced through mergers and acquisitions. Aoki (1994, p. 44) identifies to key developments in the period from the 1930s to the end of the Second World War, which have been particularly important for the development of the main bank system: first, promotion of bank consortia for long-term investment loans, and, second, the introduction of the designated banking system (*ibid.*).[42] The following quote from Aoki (1994) indicates the significant impact of the designated

[42] Although the designated banking system was introduced in 1944, that is, outside the period under consideration here, it is briefly referred to in this section as this facilitates better appreciation of the development of the main bank system.

banking system, which was introduced by the *Ministry of Munitions*, on the development of the main bank system.

> For each firm receiving military procurement orders, a single bank was designated and funds were supplied to the firm through that bank. The firm held its deposit and loan accounts with its designated bank, which may be considered as a prototype of the payment settlements account aspect of the main bank relationship (Aoki, 1994, p. 44)

It is the above structures, which constitute the foundations of the Japanese main bank system.

In summary, modernisation and Westernisation characterised Japan during the period from 1868 to 1937. Beasely (2000, pp. 114-5) claims that the modernisation of Japan was not completed until 1920 and develops the following argument regarding Japan's modernisation and Westernisation:

> Japan retained enough financial independence to resist the pressures making for conformity. Farming and commerce in the Tokugawa period had led to an accumulation of capital in private hands which proved sufficient to fund the first stages of growth, once government had provided an infrastructure and established the machinery by which to channel investment in appropriate directions. As a result, Japan did not require heavy capital inputs from abroad and had no considerable foreign debt before the Russo-Japanese War. The West provided technology, plus a knowledge of methods of business organization, introduced into Japan by foreign experts and advisers, but it had no great part in ownership or management. That increased the scope for modification of the Western model' (Beasely, 2000, pp.114-115).

In terms of the development of Japanese style corporate governance, several developments in the corporate and legal context were of significance during the period from 1867 to 1937. First, this period saw a concentration of ownership, which consequently reduced the conflict between owners and managers to a considerable extent. This particular kind of share ownership pattern in Japan has led to the development of a corporate governance system in which management is effectively controlled by the major shareholders of the company. Second, this period witnessed the emergence of some of the characteristics of the Japanese employment system (seniority based pay, life-long employment, loyalty as the basis for the employer – employee relationship and internal promotion), which have helped shape the Japanese corporate governance system. Third, another important development during this period was the introduction of the *Commercial Code*, which provided the legal framework for the development of corporate governance practices.[43] Further, and fourth, the development of the main bank system during 1868 and 1937 laid the foundation for the emphasis on debt finance in the context of the Japanese corporation and the subsequent reliance on banks as playing an important monitoring role in the context of the Japanese corporate governance system (Aoki, 1994).

5.2. 1937 – 1945: JAPAN AT WAR

The period from 1937 to 1945 was characterised by Japan preparing for and participating in War. As Nakamura (1995, p. 3) has argued: 'From the outbreak of the war with China in July 1937 until the defeat in August 1945, Japan poured all its strength into the war and, in doing so, was destroyed.' With the outbreak of the

[43] Another important development during this period was further democratisation with the male vote being given in 1925 (Teranishi, 2000, p. 46).

war with China the Japanese government began to exercise stricter control over the economy, which was continuously strengthened until the defeat in 1945 (Hirschmeier and Yui, 1975; Beasley, 1990; Nakamura, 1995). Major concerns in this context were the allocation of funds to the war effort and the reorganisation of the industrial sector for war production. Several laws were introduced during this period in an attempt to exercise control over capital and foreign trade so as to prioritise military needs (Beasley, 1990, p. 190). The *Provisional Financial Adjustment Law* was promulgated in 1937 and was concerned to prioritise the allocation of domestic funds to the armament industry (Sakuradani, 2007). Through the issuance of the *Temporary Capital Adjustment Law* and the *Temporary Export and Import Commodities Measures* direct government control over the economy were set in place. Nakamura (1995) summarises the impact of the two laws on the economy and businesses:

> The former law imposed controls on the establishment of companies, capital increases, payments, bond floatations, and the borrowing of long-term funds in an effort to channel long-term funds on a priority basis into the military industries. The latter gave the government the authority to control the production, processing, trading, holding, and consumption of commodities and raw materials related to exports and imports. (Nakamura, 1995, p. 7)

The *Key Industries Control Law* and the *Export Union Law* (Hirschmeier and Yui, 1975, p. 150) were also further attempts by the government to expand its control over the Japanese economy. Of interest is also the *National General Mobilisation Law* from 1938 because of its impact on companies. As Bearsley (1990, p. 190) has argued, this law further facilitated government control through providing a wider framework of emergency powers, such as, 'the direction of labour and materials, the regulation of wages and prices, government operation of key industries, if required, and even a compulsory savings scheme' (see also Sakuradani, 2007, p. 4). Nakamura (1995, p. 8) explained that this law enabled the government to exercise 'broad controls in such broad areas as the behavior of firms, their disposal of profits, and financial institutions' uses of funds'. Miyamoto (2005) points out that as a result of the above legal amendments the government also interfered in companies' dividend policy and directors' bonuses. Further, the proportion of external directors and executives who were large shareholders of the company was decreased and internally promoted executives became prominent. With the outbreak of the war in Europe in 1939, material shortages in Japan became a pressing problem. In order to alleviate this problem, the government set prices and introduced rationing systems for certain goods (for example, cotton and steel). As a consequence of such government measures there was a growth in the black market, which the government tried to control though the introduction of an economic police force (Nakamura, 1995, pp. 8-10). Further, through the issuance of the *September 18 Stop Order* in 1939 a ceiling was placed on prices and wages 'thereby bringing them under government control' (*ibid.*, p. 10). In 1939 as a consequence of a drought, which had negatively impacted upon the rice crop and hydroelectric power, controls and rationing systems were also introduced into many aspects of national life. For Nakamura (1995, p. 10), 'the Japanese economy by 1940 was in effect a centrally planned command economy much like that of the former Soviet Union'. Of interest in the context of this strong State dominance were proposals, which were made as part of a debate over the *New Economic Order*. These proposals 'called for separating the owners of capital from those responsible for management in order to convert businesses from private profit-seeking undertakings into "public" enterprises where production would be paramount' (*ibid.*). Financial circles were strongly against these proposals. In 1941 and with Japan engaged in the *Pacific War*, *Control Associations* (*Tosei Kai*)[44] were formed in key industries so as to further enhance the growth of the war economy. This was a further strengthening of state control as Nakamura explains:

> Although the ordinance establishing a controlling cartel in each major industry theoretically conferred great powers on association members and called for autonomous regulation in the hands of private individuals, in actuality the government took on broad supervisory powers and made the associations function as lower-echelon mechanisms of government control. (Nakamura, 1995, p. 14).

As this system, however, was not deemed to be very successful, the *Munitions Company Law* of 1943 was promulgated, which obliged companies to appoint a person responsible for production, which the government could choose and who had the right of representing the company (Tanaka, 1998; Nakamura, 1995, p. 14; Miyamoto, 2005). This 'public official' had to increase production in such way as to reflect national (i.e. set by the government) directives (Nakamura, 1995, p. 14). A further and significant development towards the end of the War, was the establishment in 1944 of the *System of Financial Institutions Authorized to Finance Munitions Companies*. These financial institutions according to the arrangements

[44] These associations reflected aspects of the debate over the New Economic Order (Nakamura, 1995, p. 14).

were backed by the Japanese government, the Bank of Japan and other financial institutions so that providing funds to munitions companies would never be a problem (Nakamura, 1995, p. 18).

Although in history writing more generally the view is often expressed that the end of World War II constituted an absolute discontinuity in structures and systems this is, however, a myth. For the case of Japan, Nakamura (1995, p. 3) has pointed to the relevance of developments during the war period for post-war developments:

> ...the war years cannot be ignored in a consideration of the postwar period. To a great extent, the system created was inherited as the postwar economic system. The industries developed during the war became the major postwar industries; wartime technology was reborn in the postwar export industries; and the postwar national lifestyle, too, originated in changes that began during the period of conflict.

There are several developments during the war period that were of significance for the development of the Japanese corporate governance system. First, the *Commerce and Industry Ministry's* and the *Munitions Ministry's* control over the economy and industry during the war is to some extent reflected in the administrative leadership in the business area of two post-war Japanese Ministries: the *Ministry of International Trade and Industry (MITI)* and the *Ministry of Transport*. According to Nakamura (1995, p. 19) 'it was during the course of wartime controls that the "guidance" relationship was established between firms and the bureaucracy, and between private banks and the bank of Japan'. Second, relationships set up in the context of the *System of Financial Institutions Authorized to Finance Munitions Companies* became important in the context of *keiretsu* (i.e. here the powerful financial groupings of major banks such as, for example, the Industrial Bank of Japan, Sanwa and Dai-ichi Kangyō; Nakamura, 1995, p. 18). Third, the seniority wage system and the lifetime employment system, both developed after World War I, became a prominent feature of the Japanese employment system.[45] As a result of seniority based promotion, a system had emerged by the end of the Second World War whereby the board of directors was composed of executive directors and non-executive directors who were subordinates of the former. Consequently, shareholder interests had 'become subordinated to the general interests of growth in the company' (Hirschmeier and Yui, 1975, p. 191). And, fourth, post-war labour-management relations also reflect developments during the war period when labour unions were replaced by *Patriotic Industrial Associations* (*Sangyo Hokoku Kai*) based on firms rather than sectors (Nakamura, 1995, p. 19).[46]

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[45] These systems were initially developed for the chemical and heavy industry sectors but then expanded into a nation-wide system as part of the government imposed wage controls from 1940-1941 (Nakamura, 1995, p. 19).

[46] Having elaborated the development of characteristics of the Japanese corporate governance system from 1868 to 1945 it is of interest to consider two questions, which have been addressed in the literature: First, was the Anglo-Saxon style corporate governance widely practiced in pre-war Japan? And, second, in what sense might one argue that the Japanese corporate governance model evolve before 1937? Watanabe (2000) holds that before World War II the Japanese model of corporate governance was quite similar to the Anglo-Saxon model of corporate governance. It prioritised shareholder property interest. He also maintains that large shareholders although they had been replaced as directors by university graduates, still had an important influence as members of the board of directors. In contrast, based on their own empirical work, Miyamoto and Abe (2004, p. 30) argue that the Japanese corporate governance structure had already begun to evolve and develop before 1937: 'It is true that the large stockholders had effective power at the early stage of these companies' [i.e. the companies they studied] history. In this sense, the corporate governance of early modern Japan was similar to that of the Anglo-Saxon model. But the governance of large stockholders had ended by the late 19th or early 20th century, and the governance of salaried managers was established by the First World War.' They thus conclude that the Japanese corporate governance system has a much longer history and pre-dates the pre-war period and, relatedly, 'Anglo-Saxon structures did not necessarily prevail within pre-war big businesses (Miyamoto and Abe, 2004, p. 30). The literature is inconclusive on that matter. For the purpose here, it is, however not important to precisely identify when the Japanese corporate governance model came into being. What is important in the context of this study is to gain an appreciation of how the characteristics of the Japanese corporate context and what is called the Japanese corporate governance model had developed within the context they were and are embedded in.

5.3. 1945 – 1989: THE EMERGENCE OF JAPAN AS A MAJOR ECONOMIC POWER

During the period from 1945 to 1989 Japan emerged from a nation, which had lost the war and whose economy had been destroyed, to become a nation with a developed economy threatening the global economic supremacy of the U.S. In the following a brief summary of the economic development of Japan after World War II and some key political developments is offered. Then three developments in the Japanese corporate context, which had a significant impact on the Japanese corporate governance system, namely cross-shareholdings, the role of the banks and Japanese style management, are discussed.

After World War II, Japan was occupied by the allied forces with the U.S. being the dominant force in the occupation army. The occupation authorities had a significant impact on Japan in terms of shaping her legal and administrative framework. For example, the constitution of Japan implemented during the occupation period reflected the U.S. notion of democracy as well as U.S. values. It is also of note that during the occupation period a close relationship between Japan and the U.S. developed, which also remained after Japan gained independence on 8th September 1951 by concluding a treaty of peace, named the *San Francisco Peace Treaty*, with forty eight countries (Perez, 1998, p. 159). The Japan – U.S. relationship was motivated by a mutual interest of both governments. The U.S., concerned about security in the light of a recovering USSR, was keen to have military bases on Japanese territory. Japan in turn, having been isolated from its neighbours because of the position taken during World War II, was keen to secure the help of the U.S. in the event of an invasion. Subsequently, Japan and the U.S. signed the *Treaty of Mutual Cooperation and Security*, which gave the U.S. a special position amongst the other treaty partners of the *San Francisco Peace Treaty*: Japan allowed the U.S. to set up military bases in Japan and in return got assurance that the U.S. would help defend Japan in the case of an invasion by (an)other country(ies) (Vogel 2002, p.1). The U.S. helped integrate Japan into the Western bloc, which was acting as a force against communist countries. Japan thus emerged after 1945 as a member of a group of so-called democratic and capitalistic countries in the context of the Cold War. Japan's position in the global political order became an important factor that helped facilitate the economic success of the country (Vogel, 2002).

The war had destroyed Japan's economy and had left 13.1 million people unemployed. After Japan's defeat, the allied forces held the view that they were not responsible for the reconstruction of her economy. This view manifested for Japan in high reparation payments and the cancellation of the indemnity payments to businesses. These payments had been promised by the wartime government to companies in case they should incur losses as a result of their war efforts (Nakamura, 1995, p. 33). The stance of the U.S. towards Japan, however, already changed as early as autumn 1946 when Japan was seen as an important ally in the

Cold War (ibid., p. 37).[47] According to Vogel (2002, p. 1), this meant that 'the United States...supported Japan's economic recovery by allowing Japan to limit the reparations paid to war victims, by creating a liberal international trade regime, and by maintaining open markets at home while tolerating Japanese trade protection and an undervalued yen'. Of significance here was that private foreign trade was reopened in 1947, which allowed citizens of the Allied countries to carry out business in Japan (Nakamura, 1995, p. 38). With the support from the U.S., Japan made a remarkable economic recovery after World War II (Grimes, 2002). Nakamura (1995, p. xvii) comments upon Japan's economic growth after 1945:

> Of unquestionably great significance, the reforms implemented following the war may without exaggeration be termed revolutionary. With new reforms carried out atop a foundation of institutions and technology handed down from prewar days, and in an environment conducive to world-wide economic growth and technological progress, the postwar Japanese economy was able to pursue its course of rapid growth in long, swift strides.

During the occupation period the allied administration carried out three key reforms: the break-up of the *zaibatsu*[48], a land reform and a labour democratisation (Nakamura, 1995, p. 25).

After Japan had gained independence in 1951 the country experienced increased economic growth from the 1950s through to the early 1970s. This growth occurred

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[47] U.S. policy further changed significantly in October 1948 in the context of a concern over developments in China. Steps were now taken to work towards the reconstruction of Japan's economy by 'removing many restrictions that had been previously imposed and decreeing that Japanese economic recovery would be expedited' (Nakamura, 1995, p. 40).

[48] The impact that the dismantling of the *zaibatsu* had on the corporate context of Japan is discussed in more detail later in the chapter.

in the context of a worldwide economic growth and was, according to Nakamura (1995, p. 53) neither the result of 'special government policies nor of a few heroic achievements, but was produced by the 'cumulative efforts of the people' and 'showed virtually a straight line of economic growth (an average economic growth rate of 10 percent)'. During this period 'Japan succeeded in reducing the proportion of imports used for the processing trade and expanded the scale of imports for domestic consumption, thus lowering the ratio of imports to GNP' (Nakamura, 1995, p. 65). The growth of Japan's economy was further facilitated through the availability of sufficient and cheap raw materials and energy, which was needed in the development of the heavy and chemical industries. The Korean War (1950-1953) also had a positive impact on the Japanese economy as the boom that it created contributed to the re-building of Japanese companies after the end of the Second World War *(ibid)*.[49] The period of economic growth after the war also showed a significant technological progress in Japan (Nakamura, 1995, p. 68).

The Japanese government had played an important role in facilitating the economic growth through various policies, which were intended to protect industry. Since 1955 the government had also set economic plans, which set out the direction of social and economic developments and the strategies and policies the government should adopt to achieve these goals and an indication of 'behavior guidelines for

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[49] Several developments had taken place prior and after the Second World War that had constituted challenges to Japanese companies. These included the move away from owner-managers to professional and hired managers (i.e. a separation of ownership and control), the dismantling of the *zaibatsu* that had led to increased competition and the democratisation of labour (e.g. establishment of firm based labour unions) (Nakamura, 1995, p. 68).

the people and for business' (Nakamura, 1995, p. 91). During this period the government also developed a special relationship with industry in providing it with administrative guidance (*gyosei shido*) (Nakamura, 1995, p. 89). Nakamura refers in the context of this state guidance to the perception that has emerged in the U.S. of *Japan, Inc.* (a phrase coming from the U.S. State Department) and in the U.K of the Japanese economy being the '"most intelligently *dirigiste* system in the world" (emphasis in the original)'.[50] In response to these perceptions, Nakamura points out that administrative guidance in Japan has a long history:

> ...it simply comes down to this: the attitude on the part of both government and business that such guidance and protection is not strange but quite natural had been taking shape for a considerable period of time, ever since the days of wartime controls. (Nakamura, 1995, p. 91)

The 1960s and the early 1970s witnessed an increased standard of living in conventional terms and a 'Westernization of the national lifestyle' (Nakamura, 1995, p. 100).

In the 1970s the Japanese economy had to overcome significant challenges: the *Nixon shock* and two oil crises (1973 and 1979; Nakamura, 1995, p. 237). The *Nixon shock* here refers to policies introduced by U.S. President Nixon in the context of his *New Economic Programme*, one of which was the 'suspension of the convertibility of the US dollar into gold' (Nakakita, 1993, p. 356). As a consequence of the new policies, managed floating exchange rates were introduced. Nakakita (1993, p. 356) comments on the effect of this on the Japanese business

50 This was the view expressed by Norman Macrae from the *Economist* (Nakamura, 1995, p. 90).

community: 'Nixon's announcement came as a shock to the Japanese business community, which had been prepared to defend to the death the Yen360 rate.'[51]

The two oil crises of the 1970s also had a significant impact on Japan, which heavily relied on crude oil as primary energy in the light of lacking domestic energy resources (Nakakita, 1993). The increase in oil price in 1973 led to an increase of prices within Japan and to panic buying in a context where suppliers withheld goods as they were anticipating higher prices. The government stepped in and tried to control inflation. As a consequence of government policy the rapid economic growth came to a halt and Japan entered a recession (Nakamura, 1995, pp. 213-218). The oil crises forced businesses to refocus, to reduce costs and introduce methods to conserve energy, which led to a reduction in crude oil consumption. Consequently production and investment in plant and equipment declined (Nakakita, 1993, pp. 356-7; Nakamura, 1995, pp. 213-218). Nakakita (1993, p. 357) summarises the effects that these changes had on the Japanese economy:

> Accordingly, the Japanese economy began to rely more on higher value-added industries, particularly automobiles, electronics, machine tools and other processing and assembling industries. This was due largely to a technological advancement taking place on the shop-floor, including total quality control (TQC), automation, and electronic manufacturing techniques. In the meantime, heavy industrial sectors, including aluminium, cement, and paper and pulp, lost their competitive edge with the ascendancy of the Asian Newly Industrializing Economies (ANIEs).

[51] This exchange rate, US1$ = Yen 360, had been in place for 22 years (Nakakita, 1993, p. 338).

The measures put into place were successful and in the 1980s the Japanese economy had recovered and its position internationally had been further strengthened. Nakakita (1993, p. 357) comments:

> With the exception of the period during the two oil crises, Japan's balance of payments continued to shop an enormous surplus, and its share of world GNP increased from 6 per cent in 1970 to 11.8 per cent in 1986.

The period from the 1950 to the 1970s was not only of significance in terms of Japan's economic success but also in terms of the development of some key economic and political institutions, which had reached maturity in the late 1970s. These economic and political institutions were perceived as having facilitated Japan's extraordinary economic success by the beginning of the 1980s. Key economic institutions in this context include, for example, the Japanese financial system, corporate system and corporate governance system as well as labour market institutions (such as, for example, life-long employment) and wage coordination and restraint. Key political institutions include the dominance of the Liberal Democratic Party (LDP), the bureaucracy and the iron triangle (Cargill and Sakamoto, 2008, pp. 31-32). The iron triangle was the close relationship between the LDP, the bureaucracy and client industries, firms and sectors. Cargill and Sakamoto (2008) explain how the iron triangle operated in practice:

> The iron triangle was in large part a feature of the political regime in pretransition Japan.[52] The client industries and firms provided electoral support to the LDP, which in turn delegated policy-making power to the bureaucracy, which in turn provided regulation and favorable policy to protect the client industries and firms. The client industries and firms

[52] Cargill and Sakamoto (2008) refer to pretransition Japan as the Japan before the introduction of liberal reforms in the latter half of the 1980s.

delegated control to bureaucrats and provided postretirement employment opportunities for bureaucrats via *amkudari*[53], the bureaucracy mobilized the support of industry and firm for the LDP, and the LDP in turn provided public resources and favourable policies to the client industries (Cargill and Sakamoto, 2008, p. 54).

It is of note that the above economic and political institutions of Japan showed characteristics that were perceived by commentators inside as well as outside of Japan as different from the characteristics of Western institutions. The reason for the observed differences, it was argued, was the particular culture of Japan that was reflected in these institutions. This point was prominently made by Ronald Dore (see, for example, Dore, 2003). It is of interest that even those commentators who wish to downplay the particular impact of Japanese culture on these institutions, recognise that Japanese institutions before the market reforms were different. An example for such a position are Cargill and Sakamoto (2008) who have argued that:-

> Japan's economic and political institutions appear to be more sensitive to risk-aversion and accepting of collectivism. Its risk-aversion and collectivism in turn render Japanese economic and political institutions resistant to change, and when change does occur, it is usually in response to a change in the external environment. Every society incorporates these attitudes in varying degrees, but in Japan's case these attitudes play a larger role in shaping economic and political institutions. Japan perceives itself as having fewer degrees of freedom than other countries in making economic and political decisions because of a limited resource base, limited land areas that can be utilized for production and living, and Japan's susceptibility to natural disasters such as earthquakes and violent weather. This in turn has provided incentives to develop institutions based

[53] The term *amakudari* means "descent from heaven" and was used for retired ministry officials who were dispatched by the government to lucrative positions in private corporations.

on mutual support, insularity, and aversion to risk and change (Cargill and Sakamoto, 2008, p. 30).[54]

It should be noted that the particular characteristics of the Japanese institutions that Cargill and Sakamoto are referring to above have not only contributed to the economic success of Japan but most importantly have also facilitated the emergence of a more egalitarian society with a life-style that was more secure and certain for its citizens. Commentators have thus pointed to the Japanese variety of capitalism as an example of a type of capitalism where the state was concerned to facilitate the well-being of its citizens through interventionist policies (Dore, 1998, 2000).[55]

In terms of Japan's international political position during the period from 1945 to 1989 we can observe a significant transformation: from a position of having been defeated in the war and being occupied by allied forces, Japan had moved to becoming a member of international organisations such as the IMF (1953), GATT (1955) and the OECD (1964). The change in the political position of Japan and its membership of international organisations was accompanied by a change in trade policy: protectionist measures (see the *Foreign Exchange and Foreign Trade Control Law*, 1949) introduced in the early post-war period were consequently replaced by attempts towards trade and capital liberalisation from the 1960s (Nakakita, 1993, pp. 361-2). Of note here is the role of the state in fostering

[54] It is of note that Cargill and Sakamoto (2008) carefully omit any reference to Japan's particular culture, which has also shaped the institutions they are referring to here. Chapter 6 explains in more detail the interrelationship between Japanese institutions and systems and culture.
[55] Chapter 6 provides a summary discussion of the characteristics of the Japanese type of capitalism.

economic development during the period from 1945 to 1989. It was state policy that had managed and facilitated the economic growth during the period. For Lee (2008), Japan is thus an example for state-led economic development and directly challenges the neo-liberalist model of development promoted by the U.S. and institutions such as the IMF and the World Bank. Lee (2008, p. 1) explains the two positions regarding development:

> [The end of the Cold War] has strengthened to a significant degree the political triumph of the "New Right" in the United States and Britain and seemingly confirmed a long-held conviction among neoliberals that the free play of market forces and a minimal role for the state in economic affairs would ensure efficiency and productivity of the economy...The critics argue that all modern economically developed states employed the practice of state-led economic development in one way or another when they began to industrialize. Opposed to this is the position that all modern economically developed states have succeeded in their development by relying predominantly on self-regulating market forces.

According to Lee (2008), Japan thus constitutes a challenge to the U.S. and the neoliberal world order. It is important to consider this clash of positions later in the analysis of the empirics (*subter*).

The period from 1945 to 1989 also witnessed important developments in the corporate context of Japan, which were of significance for the Japanese corporate governance system. These were an increase in cross-shareholdings, which had emanated from the dismantling of the *zaibatsu*, the development of the banking system and the establishment of a set of distinct employment practices for Japanese firms. These developments are discussed below.

The break-up of the *zaibatsu* under the Allied administration had significant consequences for the Japanese corporate system. The occupying forces had been particularly concerned about the *zaibatsu*, which they believed had played a significant role in supporting the State during the pre-War and War period. In addition, as Beasley (1990, p. 216) has pointed out, *zaibatsu* were seen as 'barriers to domestic competition' and hence to 'economic democracy'. Indeed, the *zaibatsu* still had substantial assets and power even after the war had ended. The plan of the occupying forces was therefore to dismantle the *zaibatsu* so as to decentralise their power and wealth. In accordance with this policy, shares of the holding company were sold through the *Holding Companies Liquidation Commission* (Yafeh, 2000) and, as a result of this, shareholdings of individual investors had increased significantly by 1949. According to Kitsuki and Nagakuba (1997, p. 4), shareholdings of individual investors had reached 68.4% in 1949. In addition, in April 1947 an Anti-monopoly Law was introduced to ensure that no successors of the *zaibatsu* could emerge (Beasley, 1990, p. 216). This development reversed soon after, however, when many individual shareholders began to sell their shares after the re-opening of the Tokyo Stock Exchange in 1949 (Kitsuki and Nagakubo, 1997). As a result of this change in share ownership, cross-shareholdings among Japanese companies emerged. Kitsuki and Nagakubo (1997) and Tanaka (1998) identify three transition periods that advanced cross-shareholding: first, during the 1950s; second, between the middle of the 1960s and the beginning of 1970s, and third, during the 1980s. As a result of the amendments to the Anti-monopoly Law in 1949 and 1953 further cross-shareholdings were encouraged. The amended law allowed companies to purchase other companies' shares and financial institutions to hold at most 10% of a company's outstanding shares, which encouraged companies to hold each other's shares. During the 1960s and 1970s another impetus that encouraged cross-shareholdings came with Japan's new membership of the *Organization of Economic Cooperation and Development (OECD)* and the liberalisation of capital markets in 1964. As the liberalisation of capital markets allowed anybody to invest in Japanese companies, cross-shareholdings increased as Japanese managers were worried about a takeover by foreign investors. In the 1980s, cross-shareholdings received further impetus as companies preferred equity finance to indirect financing (i.e. issue of shares at market value and convertible debentures). The newly issued shares at market value further encouraged cross-shareholdings (Kitsuki and Nagakubo, 1997; Tanaka, 1998). As will be shown later in the analysis of the empirics cross-shareholdings have impacted significantly on the Japanese corporate governance system (*subter*).

After the Second World War, banks played a vital role in the rebuilding of the Japanese economy. The government kept strict control over financial markets in order to facilitate Japan's attempt to catch up with other developed countries. Banks were thus able to raise funds at low interest rates from the central bank. Watanabe and Yamamoto (1993, p. 214) note: '[B]anks enjoyed a powerful position in their capacity as lenders, and carefully examined the business plans and financial condition of borrowing companies. Companies did not refuse to disclose detailed information about their operations to the banks, as the banks were an essential source of funds.' As long as companies performed well, banks did not interfere with management. Once company performance was poor, however, banks stepped in and interfered with management. Cargill and Sakamoto (2008) explain how the Japanese financial system facilitated the particular type of Japanese corporate governance system:

> The Japanese financial system...was rigidly regulated, administratively controlled, internationally isolated, and relied on the transfer of funds through private and public bank channels, as opposed to relying on money and capital markets. In fact, corporate governance was intimately tied to the financial system relying on a set of company groups or *keiretsu* [emphasis in original], centered on a large financial institution, usually one of the large city banks. This system also was known as the main bank system (Cargill and Sakamoto, 2008, p. 12).

Further, administrative guidance (especially through government departments) and insider information played an important advisory role in terms of risk assessment in the financial system. Cargill and Sakamoto (2008, p. 86) point out that in the context of the strongly regulated and internationally isolated financial system this was an adequate mechanism.

In addition to cross-shareholdings and the role of the banks as major lenders, a third characteristic of the Japanese business context that impacted on the development of the particular kind of Japanese corporate governance was Japanese-style employment practices. Japanese-style employment practices include 'life-long employment, seniority-based pay and promotion and company affiliated trade unions' (Seki, 2005, p. 378). After World War II these employment practices became standard for all employees in companies and not just skilled workers.

These employment practices encourage management to develop the skills of their employees and to enhance their sense of belonging to the company and thus raise their morale. A result of such 'nurturing' of employees is that most corporate executives were internally promoted and the corporate executive therefore came to be seen as a kind of workers' representative (Egawa, 2003).

By the end of the period from 1945 to the late 1980s the Japanese economy had been booming and had reached its height by the end of 1989. Japan had outperformed many other industrialised countries and its development was seen as a model for other countries (Cargill and Sakamoto, 2008, p. 83). During this era of economic growth in the 1980s Japan had increasingly come under pressure, especially from outside of Japan, to carry out some structural reforms. The Japanese government eventually embarked on a liberalisation programme in the second half of the 1980s. These deregulation attempts have to be understood in the context of neo-liberal policies becoming prominent initially in the U.K. under Margaret Thatcher and the U.S. under Ronald Reagan from the late 1970s (Cargill and Sakamoto, 2008) and early 1980s but soon spreading to other capitalistic developed Western economies.[56]

[56] This liberalisation programme is referred to and further elaborated upon later in this chapter.

5.4. 1990 - 2007: CRISIS AND RECOVERY

The period from 1990 to 2008 witnessed a major shift in the socio-economic and political spheres of Japan. According to Cargill and Sakamoto (2008, p. 3), this period saw 'wide swings in economic and political performance'. They argue that this period is part of a wider transition towards a market economy as well as a transition in the political regime. How significant the changes during this period were is evident from their comment on the differences between the 1980s and the 1990s:

> In the 1980s, Japan seemed invincible in terms of economic, financial, and political stability, whereas in the 1990s and the beginning of the new century, Japan seemed unable to do anything right. The distress by the late 1990s illustrated to all but a few that the "old" Japan was no longer viable. Japan needed to adapt its economic and political institutions to a new environment and, in the process, the old social contract between the government and the population began to unravel (Cargill and Sakamoto, 2008, p. 3).

For Cargill and Sakamoto (*ibid.*) this transition period is the most significant period in Japan's post-war history as it 'represents a dramatic shift in how Japan operates'. This period is also of great significance for the development of the Japanese corporate governance system. With the crisis occurring in Japan's socio-economic and political spheres, the Japanese corporate governance system, which is embedded in this crisis laden context, also came under criticism and pressure to change. In particular, the Japanese government was put under international pressure to change the Japanese corporate governance system and converge it with the Anglo-American corporate governance system. The debates over corporate governance that this study focuses upon are embedded in this crisis ridden context. An appreciation of the developments during the 1990s up to 2008 thus facilitates the analysis of these documents. Below developments during the 1990s and the early twenty-first century in the socio-political and economic sphere are summarised. The emphasis in this summary is on developments that especially impacted upon corporate governance in Japan.[57] Where appropriate, reference is made in the summary to the interrelationship between developments in the socio-economic and political spheres and the Japanese corporate governance system.

The 1990s in Japan began with the bursting of the bubble economy. This event significantly shaped the next two decades and had a far reaching impact on the socio-economic and political spheres of Japan as well as on people's well-being more generally. The latter half of the 1980s had witnessed an increase in real estate prices because liberalisation policies had made it possible for foreign institutions to enter Japan. The demand for real estate in the context of a limited supply (especially in Tokyo) coupled with a monetary policy of the *Bank of Japan*, which led to an increased supply in money and credit available, had fuelled an increase in real estate prices, which was significantly above the historical level (Cargill and Sakamoto, 2008, pp. 93-94). Cargill and Sakamoto (2008, p. 97) explain that towards the end of the 1980s market participants had 'lost perspective' and price

[57] The summary of the developments during the 1990s and the early twenty-first century has to be highly selective here. The emphasis is on those developments that help facilitate the analysis of the empirics of Chapters 6, 7 and 8. The discussion of developments in this section is, however, more detailed then in the previous section as this period constitutes the main focus of the study here.

expectations were 'no longer reasonably connected to economic fundamentals'. They comment:

> The irrational exuberance was not only embraced by the public as they were willing to pay higher and higher prices for equities and real estate. It also embraced the financial system. Supported by accommodative monetary policy, banks and other financial institutions commenced a rapid credit expansion that further supported asset inflation in the context of a flawed and incomplete liberalization process (Cargill and Sakamoto, 2008, p. 97).

Several reasons were given for the emergence of the bubble economy and its subsequent bursting. One key reason referred to in the literature for the emergence of the bubble economy was the way in which the liberalisation programme of the late 1980s was carried out and the consequences emanating from this. Cargill and Sakamoto (2008), for example, argue that the Ministry of Finance reacted to pressures from the banks, securities companies and corporations who lobbied for liberalisation in areas they would especially benefit from. In addition to this pressure, there was international pressure to liberalise the economy. The particular stance of the Ministry of Finance impacted upon the way reforms were carried out. As a consequence, Cargill and Sakamoto (2008, p. 84) argue, "[t]here was never an economy-wide perspective and philosophy of markets over a state-directed economy and, as a result, liberalization was unbalanced and incomplete'. A particular issue in this respect was that key elements of the financial system had stayed in place, for example, the close relationship between financial institutions and the Ministry of Finance and the relationship between corporations and financial institutions, which was especially facilitated through the *keiretsu* system. These monitoring mechanisms were, however, not sufficient in a context in which financial institutions could engage in new and riskier forms of lending because of the liberalisation programme. Further, transparency had not been enhanced in the new context and insider information and ministerial guidance had still been heavily relied upon In addition, the main bank system, which had an important monitoring role, began 'to unravel in the context of liberalization' (Cargill and Sakamoto, 2008, p. 98). In this context it was easy for financial institutions to engage in risky investing and lending that 'made it relatively easy for asset prices to increase at rates that could not be justified by economic fundamentals' (*ibid.*, p. 100). In addition, Kikuzawa (2002) points out, Japanese companies began to move away from raising money from the banks, which as a consequence further weakened the monitoring role of the banks (see also Miyajima and Arikawa, 1999). Watanabe and Yamamoto (1993) writing in the early 1990s also point to the lack of monitoring and argue that the Japanese corporate governance system had not adequately adjusted to contextual changes of the 1980s (*ibid.*, p. 208). This shortfall in corporate governance is also seen as one of the contributing factors to the subsequent economic crisis of the 1990s.

At the beginning of the 1990s the bubble economy burst and Japan entered a recession. The bursting of the bubble economy and the collapse of the asset prices was, according to Cargill and Sakamoto (2008), a direct result of a policy decision of the Bank of Japan:

> By 1989, the BOJ became concerned about real estate and equity prices, and the rate of inflation was beginning to increase. The BOJ began to consider an increase in the discount rate despite opposition of the MOF [Ministry of Finance]. On May 1989, despite the MOF's objections, the BOJ commenced raising the discount rate from the postwar historical low of 2.5 percent to 3.25 and eventually to 6 percent in August 1990 (Cargill and Sakamoto, 2008, p. 98).

The implications of this move were significant. Asset prices that had been at a high in January 1990 dramatically declined[58] and Japan entered an economic recession with deflation[59] and a crisis that would last for over one decade. This period in Japan's history is commonly referred to as the "lost decade" because of the lost financial and economic development.[60] Below some of the key developments during this period are referred to.

It is of interest that the bubble economy and the bursting of the bubble economy was officially for the first time confirmed in 1993 in *Heisei Go nen Nenji Keizai Houkoku, Keizai Hakusho, (Economic White Paper)* of the *Keizai Kikaku-Chō (The Economic Planning Agency)* (Keizai Kikaku-Chō, 1993). Until then the official line was that the economy was still significantly growing. In contrast, Hoshi and Kashyap (2001) point out that the '1990s began with a sharp deceleration in growth: between 1990 and 1994 the average annual growth rate of real GDP was

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[58] Equity prices declined first and were followed by real estate prices in 1991. According to Cargill and Sakamoto (2008, p. 99): 'As of August 2007, equity prices recovered to only about 45 per4cent of their high at the start of 1990. Real estate prices continued to increase until late 1991 but then commenced declining and only as of late 2006 have shown signs of increasing.'

[59] Deflation had started in 1995 and according to Cargill and Sakamoto (2008, p. 16) prices fell to at least 2007.

[60] Cargill and Sakamoto (2008, p. 101) refer to a lost decade and a half as they hold that the economic and financial crisis continued until 2005. Nakamura (2008, p. 113) also argues that the crisis 'lasted well into the early 2000s, and both Japanese firms and households suffered from the lack of economic growth for many years'.

1.5%, compared to 5.5% for the previous four years' (p.267). According to their statistics the Japanese economy had taken a sudden turn from the 1990s and Japan had to struggle with stagnation throughout this period.

The decline in asset prices in 1990 led to a financial crisis from 1990 to 1994. During this period the balance sheets of corporations and banks deteriorated and a large non-performing loan problem emerged. Both of these developments were the result of declining asset prices (Cargill and Sakamoto, 2008). A significant problem in this context related to *jūsen*. This crisis, which came to light first in 1991, was the financial crisis of the housing loan companies (i.e. *jūsen*). Hoshi and Kashyap (2001, p. 269) explain that these housing loan companies were founded in the early 1970s by city banks and other financial institutions such as trust banks and securities firms. These loan companies quickly grew specialising in home mortgage. Hoshi and Kashyap state that 'as of 1980, 95% of their loans were to individuals' (*ibid.*). The fate of the *jusen* changed, however, when they found themselves in competition with their parent banks in the early 1980s after a revision of the *Foreign Exchange and Foreign Trade Control Law*. The competition had emerged because the revised law now allowed companies to raise funds from foreign markets. It is been argued that this deregulation signalled that Japanese companies were now less dependent on bank loans in financing. Japanese banks therefore found it necessary to find new costumers. Hoshi and Kashyap (2001) refer to this, stating that as the Japanese banks lost their traditional customers, they moved into the home mortgage business. When their parent banks moved into the housing mortgage business, *jūsen* had to find other business opportunities and thus moved into the real estates market. Although the *jūsen* were able to satisfactorily expand and grow their business during the bubble boom, nonperforming loan problems became an issue after the bursting of the bubble economy in 1990 (*ibid.*). It is of note that the bursting of the bubble economy did not only adversely affect the *jūsen* but also the banks. As a consequence the monitoring strength of the banks was severely damaged. The banks and large corporations were saved through the intervention of the Ministry of Finance and the convoy system, a system of mutual support, whereby troubled banks and corporations were rescued by better performing banks and corporations (Cargill and Sakamoto, 2008, pp. 86, 103).

There was a brief recovery of the economy from 1995 to 1996. *Keizai Kikaku-Chō* (*The Economic Planning Agency*) had already reported in its *Heisei roku non Nenji Keizai Houkoku, Keizai Hakusho,* (*Economic White Paper*) in 1994 that the adjustment phase of the share prices and real estate prices had been completed as a result of the Bank of Japan's (BOJ) policy to lower its discount rate seven times between 1991 and 1993 from 6% to 1.75%. Hoshi and Kashyap (2001) comment: 'In the fiscal 1994 budget, the government resumed issuing deficit bonds. The economy began to recover. With the growth rate improving to 5.1% by 1996, recovery appeared to be on the track'. Encouraged by this growth, the Japanese government under Prime Minister Ryutaro Hashimoto embarked on a major redesign of the Japanese financial system, called the *Big Bang* (Gibson, M. S., 1998; Hall, 1998, pp. 139-158). The objective of this reform programme was to make the Japanese financial system a key component of the international financial system. The motto to support this deregulation attempt was 'Free, Fair and Global' (Vogel, 2006, p.89; Okamoto, 2005, p.69). According to Cargill and Sakamoto (2008) these reforms were based on the following principles:

> (1) To establish free, open and competitive markets; (2) to ensure fair financial practices through transparent and enforced regulation and supervision; and (3) to initiate accounting, legal, and regulatory institutional reforms to make Japan's financial system internationally compatible (Cargill and Sakamoto, 2008, p. 110).

The Big Bang resulted in legislation that led to further deregulation and liberalisation. An important change was the transfer of financial regulatory and supervisory authority in Japan from the *Ministry of Finance* to the *Financial Services Authority (FSA)*. This move ended the regulatory domination of *the Ministry of Finance* in the financial system, which had been established in the latter half of the nineteenth century (Cargill and Sakamoto, 2008, p. 111). Other changes in policy encompassed the termination of income tax cuts that had commenced in 1994, the increase in the self-pay ratio in National Health Insurance and the increase in consumption tax from 3% to 5%. The announcement of the change in consumption tax contributed to a last-minute rise in demand before the increase took effect. Deregulation involved the revision of the *Foreign Exchange and Foreign Trade Control Law*, which came into force in April 1998 and the *Financial System Reform Law*, which came into force in December 1998 (Hoshi and Kashyap, 2001, p.275). This deregulation attempt of the late 1990s is of interest in relation to the Japanese corporate governance system. The point has been made that on the face of it, in order to accomplish deregulation, the government tried to reform the market through some legal and accounting changes, the latter ostensibly bringing Japanese accounting nearer to 'global' standards (Vogel, 2006, p. 89). This focus on disclosure may of course be considered a corporate governance issue as corporate transparency is a dimension potentially contributing to corporate governance.

Despite the initial up-turn in the economy mentioned above, Japan was hit by another financial crisis. 1995 saw the liquidation of the second-largest regional bank in Japan, *Hyogo Bank* (Hoshi and Kashyap, 2001, p.268). The *Ministry of Finance* stepped in and helped save *Hyogo Bank* because of its important role in the Kobe region. Through the convoy system large Japanese city banks were required to help to rescue *Hyogo Bank.* The failure of *Hyogo Bank* negatively impacted on how Japanese banks were perceived by foreign markets. To make matters worse, foreign markets not only began to cast doubt on the soundness of Japanese banks they also became concerned that healthy banks would be required in future to participate in attempts to rescue other Japanese banks who experienced financial difficulties. This resulted in Japanese banks being charged an additional rate when they raised funds through inter-bank loans. This was called the Japan premium and it significantly eroded the profitability of the Japanese banks (Hoshi and Kashyap, 2001, pp.268-271). The financial crisis deepened in 1997 with *Sanyō Securities Company, Hokkaido Takushoku Bank* (a major city bank) and *Yamaichi Securities Company* (one of the Big Four securities firms) all failing (Hoshi and Kashyap, 2001; Cargill and Sakamoto, 2008, p. 112). During this period several corporate scandals came to light. *Daiwa Bank's* New York branch showed a significant loss in 1995 after a dealer had successfully concealed trading losses for several years. As a result, *Daiwa Bank* withdrew from the U.S. market. In 1996 *Sumitomo Corporation* reported huge losses because of an illegal transaction in copper trading. Again, an employee of the company had carried out this illegal transaction. *Nomura Securities*' illegal payment to a corporate extortionist came to light in 1997 (Cooke and Sawa, 1997). The new crisis soon intensified and led to the near collapse of the Japanese economy in 1998 (Cargill and Sakamoto, 2008, p. 15). Further, there were several corruption scandals, which involved the *Bank of Japan* and the *Ministry of Finance*. These developments led to a loss of confidence from the public in the bureaucracy. The scandals and corporate failures had a significant impact on how corporate governance was perceived. In this context, Cooke and Sawa (1998, p. 217) argue that the 'corporate governance issue was vigorously debated with a sense of urgency after a series of corporate failures in the financial services sector and scandals involving some large listed companies in Japan'. The system, which had been praised as having been a major contributor to facilitating the growth of the Japanese economy, now came to be seen as a contributory factor to the crisis of the early 1990s and the difficulties succeeding it (Cooke and Sawa, 1998). The corporate governance debate was especially concerned to investigate why corporate scandals had not been prevented and what was wrong with Japanese companies' management structures and practices, which had once been praised and seen as an advantage of Japanese companies over Western companies.

Significant during this period of crisis were some changes in the political sphere, which commentators have argued also contributed to the prolonged crisis. The most significant development was that the ruling party, the Liberal Democratic Party (LDP), lost control of government in the elections in 1993. For the first time in its history the LDP had lost the majority of seats in the lower house.[61] The new government was a coalition government consisting of eight parties and excluding the LDP (Cargill and Sakamoto, 2008, p. 16). During this period, it has been argued, politicians did not focus sufficiently on economic matters. Although the LDP regained votes in the 1994 elections it did not reach the majority and a coalition government was again formed. Further, this period saw an electoral reform as well as a reform of the bureaucracy. Of significance in terms of further pushing forward liberalisation was the election by the LDP of Junichiro Koizumi as the new Prime Minister in 2001.

Koizumi had popular support which allowed him to make significant economic and political changes during his term of office from 2001 to 2006. Aiming to solve Japan's economic and financial problems he further pursued liberalisation policies. As Cargill and Sakamoto (2008) comment:

> ...under the slogan of "There will be no economic recovery without structural reform" and "Structural Reform without sanctuary", Koizumi advocated more aggressive reforms to solve the economic and financial distress than did his predecessors. Koizumi wanted a faster resolution of the huge non-performing loan problem in the banking system, more

[61] A contributory factor to this defeat was that two groups of LDP politicians had formed their own conservative party just before the 1993 elections.

> drastic restructuring of "zombie"[62] corporations and banks, and more deregulation and privatization to increase the efficiency and competiveness of the Japanese economy (Cargill and Sakamoto, 2008, p. 18).

In advocating his policies Koizumi moved away from the gradual reform approach adopted by previous LDP administrations. Key measures taken under Koizumi were the privatisation of the *Postal Savings System (PSS)* and the restructuring of the *Fiscal Investment and Loan Program (FILP)* budget, through which the Ministry of Finance had allocated funds to targeted sectors of the economy. Postal savings, which came to 35 percent of the total savings in Japan, were the main source of funding for the FILP budget, which in turn constituted 10 percent of GDP in 2001 (Cargill and Sakamoto, 2008, p. 18). These reforms thus reduced the traditionally strong role of the government in resource allocation. During his term Prime Minister Koizumi also reduced the power of the bureaucracy through exercising strong prime ministerial leadership and consequently reduced the traditionally strong link between LDP, bureaucracy and their client industries (*ibid.*). A reform taking place during Prime Minister Koizumi's term of office, which had a significant impact on the Japanese corporate governance system, was the amendment of the *Commercial Code* in 2003. The amended *Commercial Code* allowed companies to choose either the traditional Japanese corporate governance system or the Anglo-American corporate governance system.

[62] Cargill and Sakamoto (2008, p. 103, note 2) provide the following explanation for the term "zombie" corporations: 'The phrase "zombie" was used to characterize savings and loan associations in the United States during the 1980s that were insolvent, but kept operating because of forgiveness and forbearance policies of the regulatory agencies and politicians. The phrase…became part of the common language of describing the outcome of forgiveness and forbearance policies in both Japan and the United States.'

During Prime Minister Koizumi's term of office the economy started to recover. This recovery, however, only affected certain sectors and left out others (for example, small and medium businesses and traditional sectors). Similarly, corporate profits have increased whereas wages have not. Cargill and Sakamoto (2008) point to a shift in public opinion that subsequently led to a devastating defeat of the LDP in the 2007 upper house elections:

> ...the public and policy makers supported deregulation and liberalization during the Koizumi administration, partly because of the obvious failure of the old regime in the 1990s. However, interest in further significant reform is waning. In Japan, a view has emerged among the public, media, and politicians that liberal market reform has gone too far and has caused negative economic consequences, including economic disparities among different economic sectors and segments of the population (Cargill and Sakamoto, 2008, p. 22).

Cargill and Sakamoto's (2008, p. 22) observation is of interest here: 'Politicians – whether LDP or otherwise – are likely to find it difficult to resist pressures to slow down the pace of reform and pressures to increase spending to deal with the growing social problems that have emerged as Japan moves toward a freer and more competitive structure.'

The 1990s and the early twenty-first century have witnessed a global critique of the Japanese corporate governance system and significant pressure to change it and to converge with the Anglo-American corporate governance system. The way in which the government dealt with the pressure to change the Japanese corporate governance system reflects the context of the 1990s and the early twenty-first century. Similarly, the public debate over corporate governance, which emerged in the early 1990s and the debate of the various constituencies involved in the debate have also been shaped by this context. In other words, the proposals for change to the Japanese corporate governance system and the changes implemented to that system have to be understood as embedded in the various concerns and processes to deregulate and to liberalise the Japanese economy and its financial institutions as well as the economic, financial and political crises during this period. Further, the changes to the Japanese corporate governance system during the 1990s and 2000s have to also be understood in the context of changes to the Japanese corporate system. Of special significance here was the unravelling of the main bank system and the reduction of ministerial control over the financial system through the various deregulation and liberalisation policies. These changes weakened the traditional Japanese monitoring system, which had heavily relied on the monitoring function of the main banks and ministerial guidance in the context of risk assessment. Further, in the context of Japanese companies searching for ways out of their financial difficulties, proposals were made that threatened Japanese management practices and especially their emphasis on employees. *Nihon Keieisha Dantai Renmei* (*Nikkeiren*), the Japan Federation of Employers' Associations, published a book entitled '*Shinjidai no Nihontekikeiei*' in 1995 with recommendations of how to overcome the crisis companies were facing. The book advocated employment flexibility to reduce the high labour costs, which were understood to be the key component of the high cost structures of Japanese companies. It recommended that the companies should shift to replacing permanent employees with part time employees, contracted employees and temporary workers from a temporary staff service agency so as to cut costs. Such practices potentially threaten life-long employment and engender a move away from the focus on employees, which was the traditional focus of the Japanese corporate governance system. A major step in the move away from the Japanese corporate governance system was the revision of the *Commercial Code* of 2003 to allow companies to choose either the Japanese corporate governance system or the Anglo-American corporate governance system.

5.5. SUMMARY

Chapter five has provided a brief overview of Japan's emergence from a feudal economy in the latter half of the nineteenth century to a fully developed market economy in the 1970s, the country's experience of an economic and political crisis in the 1990s and the beginning of recovery after 2005. A particular emphasis was also placed in this historical overview on a summary of developments in the corporate system of Japan and its impact on the Japanese corporate governance system. The developments outlined in chapter five provide insights into the context in which the public corporate governance debate in Japan and the corporate governance debates of the various Japanese constituencies were embedded from 1989 to 2008. Having provided insights into the historical context in which corporate governance in Japan is embedded in, the next chapter, chapter 6, offers a brief comparison of the characteristics of the Japanese and Anglo-American corporate governance system and corporate system and an analysis of the key issues and concerns of the public debate over corporate governance as evident in Japanese newspapers and a summary of key issues and concerns addressed in public pronouncements on corporate governance of key Japanese constituencies.

CHAPTER 6

THE CORPORATE GOVERNANCE DEBATE IN JAPAN (1989 - 2007): SOME KEY INSIGHTS

In the debate over the Japanese corporate governance system an emphasis has been placed on the differences between the Japanese corporate governance system and the Anglo-American corporate governance system. Critics of the Japanese corporate governance system put particular emphasis on the following characteristics of the Japanese business system and the Japanese corporate governance system, which for them impacted negatively on the effectiveness of the corporate governance system: the powerful role of and influence upon management by the banks as the major providers of capital, the cross-shareholdings, and, the system of corporate and external auditors as specified by the *Commercial Code* (Cooke and Sawa, 1998). Comparing the Japanese system of corporate governance with what was perceived to be a more effective and thus better UK/US model led to an increase in argumentation that Japanese companies should be required to adopt the US model of corporate governance (Yoshikawa and Phan, 2003; Egawa, 2005). In a context of highlighting the identified differences between the two corporate governance systems, Japan was put under pressure to change its corporate governance system and to converge with the Anglo-American corporate governance system during the period this study focuses upon (1989-2007). The way in which corporate governance was debated in Japan and the way the pressure to change the Japanese corporate governance system was either perceived as a threat or an opportunity reflects specific characteristics of the Japanese context, including Japanese cultural values and its unique type of capitalism.

An understanding of the Japanese corporate system and Japanese capitalism and how they reflect Japanese culture is thus crucial for the analysis of the two empirical sites of this study, i.e. the bilateral trade negotiations between Japan and the U.S. and the development of the *Corporate Governance Principles* of the *Japan Corporate Governance Forum*. Further, there is also a need to gain an understanding of the key Japanese constituencies that were participating in the corporate governance debate. Such an understanding facilitates an appreciation of the location of the two key constituencies focused upon here, namely the Japanese government and the *Japan Corporate Governance Forum*. And, as the empirical material analysed here is part of a broader public discourse on corporate governance in Japan, there is a need to gain an appreciation of the trends in and key issues of this debate. Chapter six aims to provide insights into the above key areas. The structure of the chapter is as follows: first, a brief elaboration of the key components of the Anglo-American and Japanese corporate governance system, the Japanese corporate system and Japanese type capitalism; second, brief insights into the key Japanese constituencies involved in the corporate governance debate and their views on corporate governance; and, third, a discussion of the trends in and key issues of the public debate on corporate governance as evident in the main daily general and financial newspapers in Japan.

6.1. CORPORATE GOVERNANCE SYSTEM, CORPORATE SYTEM AND TYPE OF CAPITALISM

This section of the chapter initially briefly summarises important differences between the Japanese and Anglo-American model of corporate governance. It then outlines key elements of the Japanese corporate system and the Japanese type of capitalism.

6.1.1. *Characteristics of the U.S. and Japanese Corporate Governance Systems*

Much has been written on the difference between the U.S. (Anglo-American) and Japanese corporate governance systems.[63] Drawing from the literature and adopting a critical and contextual perspective, a brief summary and comparison of the characteristics of the two national corporate governance systems is provided.

The Anglo-American corporate governance system is commonly referred to as an outsider system, that is, a market-based system whereby shareholders from the outside exercise control over and through management. The source of control lies with the owners of the company, i.e. the shareholders. The goal of the firm under the Anglo-American model is thus defined with reference to its owners, that is, in conventional terms, profit-maximisation or, in Modern Finance Theory, the maximisation of shareholders' wealth (Schulz, 2004). In contrast, the Japanese

63 The corporate governance system is understood to encompass corporate accounting.

model of corporate governance is an insider system whereby stable insider relationships are the basis of control over and through management. This model reflects the Japanese notion of the community firm with its emphasis on stakeholders rather than shareholders as the primary beneficiaries of corporate activity. Stakeholders and especially employees are thus the source of control in the Japanese corporate governance model. The goal of the firm, to increase long-term market share, reflects the emphasis on employees (Schulz, 2004; see also Dore, 1973).

The monitoring mechanisms of the Anglo-American and Japanese corporate governance models differ significantly and reflect the emphasis on either *outsiders* or *insiders*. In the context of the Anglo-American model these monitoring mechanisms include institutional shareholders, the board of directors, the stock market, (disciplinary) takeover, bankruptcy or receivership/liquidation procedures and transparency/accounting disclosure. In the case of the Japanese model, the monitoring mechanisms include government ministries, the "Old Boys"[64] network and the President's Council (Dore, 2003; Schaede, 1995).

In the debates over corporate governance more generally, the board of directors and the number of non-executive directors on the board have been highlighted as key features of an effective corporate governance system. It is thus of interest to

[64] Rixtel and Hassink (2002, p. 1) explain that in Japan there is 'a movement of retired top staff members (so-called "old" boys or the mechanism of "descending from heaven" [amakudari]) from the Japanese Ministry of Finance (MoF) and the Bank of Japan (BoJ) into the boards Japanese private banks'. This practice also applies to other large private companies.

elaborate the key differences between the traditional Japanese board of directors and that of the Anglo-American board of directors. The structure of the Japanese board of directors also significantly differs from the Anglo-American model. Characteristics of the Anglo-American board include its committee structure and the role of independent non-executive directors as an important monitoring mechanism (Mallin, 2007; Solomon, 2007; Monks and Minow, 2008). In contrast to this set up, the Japanese board of directors does not have a committee structure and mainly consists of corporate insiders, that is, salaried managers promoted from within the company. Board membership also overlaps with membership of the top management team. Further, in contrast to Anglo-American companies, Japanese companies have a two tier board system, which consists of the board of directors and the board of auditors. The board of auditors have the role to monitor the board of directors (Ahmadjian, 2003, p.229; see also Bonn et al., 2004).

Further, the Anglo-American and Japanese corporate governance models differ in terms of the worldviews they reflect. The Anglo-American model is underpinned by neo-liberalism, a characteristic of which is the assumption and legitimisation of (narrowly) self-interested owners and managers and other actors. It is these assumptions and presumptions about human nature that are reflected in the system of punishments and rewards, which are an essential part of the Anglo-American corporate governance model. According to Dore (2003, p. 135):

> The Anglo-Saxon system of *external* controls works to keep managers honest and efficient by threatening punishment – punishment through take-over as a result of the impersonal workings of the stock market, or

> punishment through dismissal by a board of directors, dominated by External Directors whose job is explicitly defined as representing the interests of capital-providing owners.

The Japanese model is based on a worldview derived from Mencian and Sung Confucianism, characteristic of which is an 'ethical tradition of dutifulness' and an 'ethical vocabulary of responsibility, guilt and shame' (Dore, 2003, p. 136; see also Dore, 1987). This ethical tradition is reflected in the internal controls of conscience and peer pressure that are part of the Japanese corporate governance system. As Dore (2003, p. 135) explains:

> The Japanese system of internal controls works – through face-to-face, not impersonal, arm's length relationships – by exerting moral pressure on managers' conscience.

These specific characteristics of Japanese culture have also impacted upon and are reflected in the Japanese Corporate System and the Japanese type of capitalism.

6.1.2. Characteristics of the Japanese Corporate System

The Japanese corporate governance system as an embedded system reflects the particular characteristics of the Japanese corporate system: cross-shareholdings, main bank system, specific employment practices and the Japanese type firm. It is these corporate characteristics that render the Japanese corporate governance system different from corporate governance systems of other countries, including that of the U.S. Through cross-shareholdings, strong and interlocking relationships have been established, which also create a sense of shared interest between the members of groups (e.g. in a *keiretsu*). Further, the concept of the Japanese type firm significantly shapes the Japanese corporate governance system. For example, banks, and in particular the *main bank,* are the main suppliers of funds to the companies. The main bank thus has a monitoring and disciplining role but only actively gets involved in managing the firm in crisis situations when it dispatches representatives to the respective company. The monitoring of top management by the main bank according to Miyajima (1998, p. 35) is a disciplinary mechanism that is a form of 'contingent governance'. Miyajima (1998, p. 35) explains that banks in carrying out their monitoring and disciplinary role 'rely on passive stable shareholders who do not interfere in firm management to mitigate agency problems that might occur as a consequence of the dispersed ownership of the corporation'.

It is of note that managers of Japanese-type firms are not under the same kind of pressure from stock markets as are Anglo-American firms to achieve short-term results. This is because of the stable cross-shareholdings amongst the members of corporate groups, a set-up that has encouraged growth-oriented behaviour and a long-term horizon (Miyajima, 1998, p. 35). Another characteristic of the Japanese–type firm is its emphasis on employees, which is reflected in employment practices such as life-long employment (according to Dore, 2003, p. 136 'career employment' in contrast to the 'job employment' of the Anglo-American firm), seniority-based pay and promotion. The emphasis on employees also impacts on executive decisions, which on the face of it are guided more by a stronger sense of responsibility to fellow employees than is the case in Anglo-American firms focused upon shareholder interests (Dore, 1998). Because of its emphasis on employees, the Japanese-type firm is also called a community-like corporation (Inagami and Whittaker, 2005). Our brief description of the Japanese corporate system has highlighted the major differences in terms of monitoring and disciplinary mechanisms between the Japanese-type firm and the Anglo-American type firm. In summary, in contrast to the Anglo-American context with its reliance on *external* monitoring and disciplinary mechanisms, the Japanese-type company relies on *internal* mechanisms. For Dore (e.g. 2003, p. 133), both mechanisms, which reflect the particular context in which they are embedded, may be equally effective: 'effective mechanisms which impose discipline on those who manage corporations can be not external at all, but *internal*' (emphasis in the original).

6.1.3. Key Characteristics of Japanese Capitalism

The literature has pointed to significant differences between the types of capitalisms evident in capitalistic countries globally and thus Japan and the U.S and U.K. (Albert, 1993; Berger and Dore, 1996; Dore, 2000; Yamamure and Streeck, 2003). The corporate governance systems of the U.S. and U.K and Japan as embedded systems reflect as well as shape the types of capitalism of the context they are embedded in. In the literature these types of capitalism have been referred to as the Anglo-American model of capitalism (in the U.S. and the U.K.) and Rhineland capitalism (in Germany and Japan) (Albert, 1993). Dore, in his seminal work on the Japanese type of capitalism (1998, 2000) has identified five areas in his discussion of the characteristics of Japanese capitalism, which also highlight how Japanese capitalism differs from other forms of capitalism. These areas are: structure of the corporation,[65] competition, role of government, macroeconomic management and income distribution. In the Japanese context, Dore has pointed out that there is a general preference for long-standing relational contracting (for example, within *keiretsu* firms) and even competition between market rivals may be moderated by sectoral industry organisations. In such a case, a sectoral industry organisation would take on the role of a quasi-community.[66] The role of the government in the Japanese context is also different because there is less reliance on market mechanisms. The Japanese government used to have a significant role in indicative planning and the allocation of investment resources and still has an 'important role as umpire between competing private interests' (*ibid.*, p. 776). In terms of macroeconomic management there is 'greater room for manoeuvre [in Japan] than in most advanced capitalist countries (e.g. a brake on wage inflation through the "spring struggle system")' (*ibid.*, p.p. 776-7). And, in terms of income distribution, wages and salaries are less dispersed in Japan. Dore also points here to the 'solidaristic egalitarian features' of the Japanese capitalistic systems, such as, for example, progressive income tax, high inheritance tax, a well-funded and a fairly generous level of pensions (*ibid.*, p. 777).

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[65] See our discussion above.

[66] Dore (1998, p. 776) here refers to an example of the steel industry in Japan whereby the orders of one steel company, which had been badly damaged during an earthquake, were taken on by other steel companies while the damaged steel company was rebuilt. Once the steel company was operational, its customers were returned by the other steel companies.

It is of note that the various elements of the Japanese corporate governance system, the Japanese corporate system and the Japanese type of capitalism have not been static but in flux during the period from 1989 to 2007, the focus of our analysis here. These changes have occurred because of a complex set of pressures, reflected in and partly constituted by the bilateral trade negotiations. Because of the way the various areas of the Japanese system interrelate, a change in one area may significantly impact on other areas and thus the system as a whole. In other words, changing the corporate governance system may engender change in the corporate system and in the Japanese type of capitalism and in the general socio-economic context. Interesting in this respect is consideration of what Dore (1998, p. 777) terms 'psychological consonance', which constitutes a key form of systemic cohesion (the other being 'institutional interlock')[67] in the Japanese system. Psychological consonance means that various parts of the system require people to behave in similar ways, that is, calls on similar behavioural disposition, consistently emphasising certain values. What Dore (*ibid.*) refers to here are characteristics of Japanese culture that shape people's behaviour especially:

1. a willingness to enter binding long-term commitments (i.e. very moderate degree of liquidity preference)
2. a greater concern for long-term rewards than for short-term gains
3. a concern for the emotional and moral quality of the social relationships involved in economic transactions, the friendships and the mutual obligations they generate, as well as their mutual profitability (friendships include firm-to-firm relations)

[67] This form of systemic cohesion is based on, for example, preconditions such as cross-shareholdings, lack of hostile takeovers and diminished shareholder pressure leading to a commitment not to lay off workers in times of recession or the ability to 'bear extra short-term costs to maintain relations with suppliers in order to maintain a reputation for fair dealing and the advantages of the supplier's future co-operation (Dore, 1998, p. 777).

4. a tendency to view group solidarity as an important ingredient of that emotional and moral quality (the group can be one's firm, one's nation)

5. the egalitarian perception that group solidarity becomes impossible if inequalities, either of material reward or respect, become too wide

An interesting question here, which we address in our analysis below, is whether and how changes in the Japanese corporate governance system also constitute threats to the Japanese way of life and ethical values.

6.2. KEY JAPANESE CONSTITUENCIES OF THE DEBATE ON CORPORATE GOVERNANCE IN JAPAN

There are some key Japanese constituencies [68] in the debate over corporate governance in Japan whose views have variously influenced the public debate. Here the following key constituencies, which were influential because of their specific location within the Japanese socio-economic and political context, and their key contributions to the debate over corporate governance in Japan are briefly discussed: *Tokyo Shouken Torihikijyo* (Tokyo Stock Exchange), *Nippon Keidanren* (Japanese Business Federation), *Keizai Doyukai* (Japan Association of Corporate Executives), *Kigyō Nenkin Kikin Rengoukai* (Pension Fund Association), *Nihon Kounin Kaikeishi Kyoukai* (The Japanese Institute of Certified Public Accountants), *Nihon Kansayaku Kyoukai* (Japan Corporate Auditors Association), *Shakai Keizai*

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[68] "Constituency" here refers to an organisation or interest group.

Seisansei Honbu (Japan Productivity Centre for Socio-Economic Development) and *Nihon Koporaito Gabanansu Foram* (*Japan Corporate Governance Forum*)[69].

The above constituencies contributed to the debate on corporate governance in a context whereby corporate governance and accounting are regulated by the state. The emphasis in Japan on the state as a regulator may be explained with reference to historical developments in the latter half of the nineteenth century. As Oguri and Hara (1990, p. 40) summarise:

> In the Japanese context, the pre-eminence of public or state regulation is not unique to accounting but rather a pervasive feature of the social fabric of the nation. It is ascribable primarily to the nation's late entry into the global race for capitalist modernisation in the nineteenth century and to the leading role played by the bureaucracy in that drive for modernisation.

The legal framework, regulating corporations in Japan, has a dual structure, which was substantively a result of developments in the nineteenth century and after the Second World War. Japan developed its *Commercial Code* based on German law in the late nineteenth century and its *Securities and Exchange Law* based on U.S. law after 1945 (see below). This dual structure of the law was in existence at the beginning of the period that is the focus of this study here (i.e. 1989 – 2007). The emphasis on the law in regulating corporations is of relevance as any changes to corporate governance and accounting will have to be administered by the relevant

[69] The discussion of the key constituencies and their contributions to the debate focuses on issue, that are deemed important in the context of the two case studies here. The objective of this section of the chapter is therefore not to provide a detailed analysis of the various constituencies and their contributions. Such analyses would be major studies in themselves and would go far beyond this study here.

ministries and implemented through the law.[70] Within this framework of state regulation the various constituencies express their opinions and variously aim to influence and shape the law under revision. Constituencies, for example, are consulted and invited to comment on draft proposals of the law by the relevant ministry.[71] In addition, the various constituencies issue public statements in which they express their opinions in terms of, for example, corporate governance.[72] Below a brief description of nine Japanese constituencies and their public statements on corporate governance during 1989 and 2007 is offered.

6.2.1. Tokyo Shouken Torihikijyo (Tokyo Stock Exchange)

The *Tokyo Stock Exchange* is the largest and most significant of the five Japanese stock exchanges.[73] The *Tokyo Stock Exchange* was founded on 15 May 1878 and started trading on 1 June 1878. Later, in order to facilitate the war economy all eleven stock exchanges that were then operating in Japan were unified during the Second World War (1943) to form the *Japan Securities Exchange,* which was subsequently dissolved under allied occupation in 1947. On 16 May 1949 the

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70 The Japanese system of state regulation is modelled on the German system of state regulation of the nineteenth century (Ogura and Hara, 1990).

71 The opinions expressed and comments made on revisions of the *Commercial Code* and the *Securities Exchange Law* by the individual constituencies are not publicly available for the period under focus here. Information on submissions is only released in highly aggregate form by the ministries, for example, in terms of the number of submissions received from organisations and individuals.

72 Most of the statements are available in the Japanese language on the Japanese web-sites of the bodies constituting the constituencies. Some constituencies, such as, for example, *Keidandren*, have English websites (http://www.keidandren.or.jp/english) with translations of these documents. The English websites, however, are in many cases not as comprehensive as the Japanese web-sites.

73 The five stock exchanges of Japan are currently in Tokyo, Osaka, Nagoya, Fukuoka and Sapporo (Tokyo Stock Exchange, 2001a).

Tokyo Stock Exchange in its present form was founded. In the process of deregulation attempts the *Tokyo Stock Exchange* was demutualised and became *Tokyo Stock Exchange Inc.* in 2001 (Tokyo Stock Exchange, 2001b). Today *Tokyo Stock Exchange* (TSE) is one of the five largest stock exchanges globally.

The *Tokyo Stock Exchange* became actively involved in the corporate governance debate in the late 1990s. It conducted questionnaire surveys in 1998, 2000, 2003 and 2005 to ascertain information about the corporate governance practices of its listed companies (Tokyo Shokentorihikijyo, 2005). In 2004 it issued its *Principles of Corporate Governance for Listed Companies*, which reflected recommendations made by the *Committee on Listed Company Corporate Governance*. This committee had been set up by the President of the *Tokyo Stock Exchange* in 2002 to enhance corporate governance in Japan and to attract Japanese as well as foreign investors (Tokyo Shokentorihikijyo, 2004). The members of the committee included representatives from the business world, academia, pension funds, think tanks and the media. The *Tokyo Stock Exchange* defines the purpose of the *Principles of Corporate Governance for Listed Companies* as follows:

> Enhancing corporate governance should be accomplished though [!] the voluntary efforts of listed companies combining with the appraisal of such by the shareholders and investors participating in the market, and the purpose of these Principles is to offer the foundation of common understanding necessary for doing so (Tokyo Stock Exchange, 2009a).

In 2007 the *Tokyo Stock Exchange* issued a *White Paper on Corporate Governance* for TSE listed companies. The motivation for this was a perceived need for better practices in corporate governance:

> ...stock exchanges have the obligation to call for improvements based on their conclusions and to develop an environment for facilitating for improvements by providing standards for necessary issues. The widespread application of better practices for listed companies is required more than ever in corporate governance (Tokyo Stock Exchange, 2007a).

A further *White Paper on Corporate Governance* was issued in January 2009[74] outlining corporate governance practices with a view to improving current corporate governance practices and thus to attracting foreign investors (Tokyo Stock Exchange, 2009b).

6.2.2. Nippon Keidanren (Japanese Business Federation)

Nippon Keidanren, the *Japanese Business Federation*, is an organisation comprising of companies, industrial associations and regional economic organisations. It is an amalgamation of *Keidanren* (Japan Federation of Economic Organizations) and *Nikkeiren* (*Japan Federation of Employers' Associations*), which took effect from 2002. *Nippon Keidanren* currently has a membership of 1609, including amongst others 1,295 companies, 129 industrial associations and 47 regional economic organisations (Nippon Keidanren, 2009)[75]. It has a broad remit:

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[74] This White Paper is outside the period focused upon in this study, that is, 1989-2007.
[75] The membership data is for March 2009 (Nippon Keidanren, 2009).

> Nippon Keidanren, for this purpose, shall establish timely consensus and work towards resolution of a variety of issues concerning Japanese business community, including economic, industrial, social, and labor. Meanwhile, it will communicate with its stakeholders including political leaders, administrators, labor unions, and citizens at large. It will urge its members to adhere to Charter of Corporate Behavior and Global Environment Charter, in order to recover public confidence in businesses. It will also attempt to resolve international problems and to deepen economic relations with other countries through policy dialogue with governments, business groups and concerned international organizations (Nippon Keidanren, 2009).

Nippon Keidanren has published various statements on corporate governance since the latter half of the 1990s. In 1997 it published its "*Urgent Recommendation Concerning Corporate Governance*" (Nippon Keidanren, 1997). The Recommendations were developed to respond to a widespread interest in and discussion of corporate governance in Japan. *Nippon Keidanren* stress in their recommendations that 'in order to maintain and strengthen their international competiveness into the twenty-first century in the context of an age of mega competition, Japanese businesses must realize a form of corporate governance that meets global standards' (*ibid.*). *Nippon Keidanren* were motivated to engage in the corporate governance debate because of a series of corporate scandals:

> At Keidanren, however, we are deeply disturbed by the recent string of corporate scandals, and we therefore wish to recommend a strengthening of the function of corporate auditors and a review of the system of shareholder derivative lawsuits as measures to be implemented soon to deal with the issue of corporate governance (Nippon Keidanren, 1997).

Nippon Keidanren thus call for a revision of the law in order to strengthen the corporate auditor's function and a review of the derivative lawsuit system. At the same time they stress the need for companies to take their own initiatives and 'formulate their own guidelines for corporate behavior and strive to full compliance with them' (*ibid.*).

In 2000 *Nippon Keidanren* published its *Recommendations Concerning Commercial Law Reform* (Nippon Keidanren, 2000a). It stresses the urgency of a law reform in a context where 'Japan's economic environment is being transformed by a range of factors, including economic globalization, the information technology revolution, changes in the industrial structure, and the expansion of capital markets' (*ibid.*). A revision of the Commercial Law should thus ensure the enhancement of Japan's competiveness globally. Of particular interest in terms of the corporate governance debate is that *Nippon Keidanren* supports the changes proposed in the draft legislation for strengthening the auditor system and to amend the shareholders' derivative suit system and that *Nippon Keidanren* makes proposals for an improvement of the Stock option system with a view of further facilitating its use (*ibid.*).

In 2000 *Nippon Keidanren* issued another document especially concerned with corporate governance, *Points of Discussion Relating to Corporate Governance in Japanese Public Companies (Interim Report)* (Nippon Keidanren, 2000b). *The Points of Discussion* are prefaced by the following statement, which highlights the increasing importance of shareholder interests:

> It will be necessary for companies to build corporate governance that places even more importance on shareholder value. For this purpose, it will be important to (1) improve the speed and strategy of management; (2) ensure

> the transparency of corporate behavior; and (3) enhance disclosure and accountability (Nippon Keidanren, 2000b).

The corporate governance components that *Nippon Keidanren* addresses in its statement are shareholder meetings and board of directors and board of corporate auditors. Interestingly, *Nippon Keidanren* call again for less regulation and argue that 'corporate organization should be left to the independent judgment and discretion of each company'. In terms of disclosure they argue that 'evaluation should be left to the market' (Nippon Keidanren, 2000b). Overall, for large-scale public companies, Nippon Keidanren hold that deregulation of the *Commercial Code* would be desirable (*ibid*).

Another key contribution to the debate on corporate governance was made by *Nippon Keidanren* in 2003 in its *Proposal for Revision of the Corporations Law* (Nippon Keidanren, 2003). *Nippon Keidanren* refers in the introduction to its Proposal to 'requests advanced by the business community regarding greater flexibility in the range of options available for group organization, streamlining corporate governance requirements, and a wider range of methods for financing and returning profits to shareholders'. In the context of such developments, *Nippon Keidanren* presents its key positions in the Proposal.

6.2.3. Nihon Seisansei Honbu (The Japan Productivity Center)

Shakai Keizai Seisansei Honbu (Japan Productivity Center for Socio-economic Development, JPC-SED)[76] was established in 1994 through a merger of *Shakai Keizai Kokumin Kaigi* (Social Economic Congress of Japan, SECJ) with *Nihon Seisansei Honbu* (The Japan Productivity Center, JPC). The origin of this organisation can be traced back to March 1955 when *Nihon Seisansei Honbu* (The Japan Productivity Center) had been established through cabinet approval to consider "measures for productivity improvement" (Japan Productivity Center, 2009). *Shakai Keizai Seisansei Honbu* (Japan Productivity Center for Socio-economic Development) was later renamed *Nihon Seisansei Honbu* (The Japan Productivity Center) in April 2009 (Japan Productivity Center, 2009). The JPC-SED is an independent organisation consisting of business people, academic experts and labour representatives. It subscribes to the following three principles: "expansion of employment; cooperation between labor and management; and fair distribution of the fruits of productivity among labor, management, and consumers" (*ibid.*)

The JPC-SED began to engage in the corporate governance debate in 1998 when it conducted a questionnaire survey on corporate governance of the executives of 5000 listed companies' executives. According to the questionnaire survey, over 60% of those surveyed anticipated that in the future the Japanese corporate governance system would still value both employees and shareholders, that is, Japanese

[76] *Shakaikeizaiseisanseihonbu* is referred to in this study as JPC-SED as all the documents discussed here have been published before the JPC-SED was renamed in 2009.

companies would not simply follow the Anglo-American corporate governance system, which only pursued shareholders' wealth. Further, around 70% of the respondents expected the board of directors to be the key monitor of business activities. At the same time, however, 80% of the respondents expressed the view that the board of directors had lost substance. In order to resolve this problem and to strengthen the board of directors they suggested a separation of the decision-making function and the execution or executive function of the board of directors, which is common in Anglo-American corporations, and a reduction in the number of members of the board of directors. Other suggestions were the introduction of the fixed terms and retirement age system for corporate executives in order to replace the old executives with younger executives and to thus bring new energy to the board of directors.

Further, the corporate executives in their responses to the questionnaire recognised the importance of a monitoring system for managerial actions. They expected the board of directors, corporate auditors, labour unions, middle management and in-house legal departments to constitute the internal monitoring system, and shareholders, institutional investors, customers and business partners to constitute the external monitoring system. The respondents also strongly stressed the need to enhance disclosure. In order to achieve better disclosure, the executives suggested the introduction of non-executive directors and regular meetings between management and large shareholders. The respondents also suggested that companies should increase their contacts with institutional investors and the mass media for disclosure purposes. Overall respondents to the survey held the view that although it was necessary to make legislative prescriptions for corporate governance, it was, however, more important for each company to take substantial measures themselves and establish an open company through disclosure (Shakai Keizai Seisansei Honbu 1998a, b).

The JPC-SED also conducted a survey of statements on company ethos in 1998. They reported that Japanese companies were customer oriented and thought highly of their employees. Companies also aspired to harmoniously co-exist with society. In contrast to employees, shareholders were not frequently referred to in statements on company ethos. Indeed, only 21% of the respondents mentioned shareholders in their statements on company ethos (Shakai Keizai Seisansei Honbu 1998c).

The JPC-SED, reflecting its status as an independent organisation consisting of business people, academic experts and labour representatives, is especially interested in the Japanese management system. The JPC-SED has thus frequently conducted surveys on Japanese-style human resource management since 1997. In 1999, a survey revealed that 67.5% of the companies surveyed planned to reduce the number of their permanent employees. At the same time, however, Japanese companies still wanted to maintain the life-long employment system, which was a key characteristic of the Japanese corporate system. The survey indicated that 54.8% of the companies surveyed intended to maintain this practice. Moreover, over half of the companies that had responded to the survey indicated that the business performance of their companies had been poor were still keen to maintain the practice of life-long employment. Interestingly and somewhat contradictory, the companies keen to maintain life-long employment at the same time planned to reduce the number of their permanent employees and to increase outsourcing. In order to maintain life-long employment the companies surveyed thought it was important to reduce the ratio of seniority based payment and introduce performance related pay schemes for their employees who were at management level instead. In fact, 39.4% of the companies surveyed reported that they were moving from seniority based payment to performance related pay schemes for their management level employees (Shakai Keizai Seisansei Honbu, 1999).

The 2000 survey indicates that companies were still considering a change of their employment practices. 54.2% of the companies surveyed responded that they planned to reduce the number of their permanent employees and gradually increase mid-career employment. The responses of the companies indicated that the ratio of permanent employees would decline from an average of 84.7% to an average of 74.2%, while the ratio of contract employees with highly specialist capabilities and contract employees and part-time employees would increased from 1.6% to 5.9% and from 13.7% to 19.5% respectively (Shakai Keizai Seisansei Honbu, 2000).

In 2005, a further survey revealed that 43.9% of the companies surveyed had employed non-executive directors (64.9% of the companies that had over 5000 employees), and 44.7% of them had introduced an operating officer system (67.6%

of the companies that had over 5000 employees). Further, 44.7% of them had established internal reporting systems (78.4% of the companies that had over 5000 employees), which had gained much attention as a means of preventing corporate misconduct. The survey showed that although performance related pay systems for management level employees had been advanced, only 15.0% of the companies had an employee remuneration committee (Shakai Keizai Seisansei Honbu, 2005).

In summary, the JPC-SED surveys indicated that during the period from 1998 to 2005 company practices in relation to corporate governance had begun to change. There was a move to incorporate aspects of the Anglo-American corporate governance system and thus respond to the critique of the Japanese corporate governance system. It is of note that despite this move companies still had expressed a concern to maintain life-long employment.

In 2001 a special committee of labour-management relations *Roushi Kankei Tokubetsu Iinkai* (Labour-Management Relations Special Committee) of the JPC-SED launched a series of research studies aimed at investigating Japanese style management. It published an interim report on 14 December 2001 and interim recommendations on 12 December 2002 and announced its final recommendations on 31 July 2003. The aim of the research was to gain insights into the influences on the employer-employee relationship and the new issues for the employer-employee relationship arising from changing business management practices and a changing corporate governance system (Shakai Keizai Seisansei Honbu, 2002a,b; Japan Productivity Center, 2003).

The 2001 interim report showed that both the employer side as well as the employee side were of the opinion that special attention was now being paid to shareholders and that shareholders were considered in the process of making business decisions (Shakai Keizai Seisansei Honbu, 2001). This focus on shareholders indicated a shift away from a focus on employees as had been the case in the context of Japanese management practices. The interim report also revealed that the labour side felt that management had adopted short-termism (45.2%) whereas a smaller proportion on the management side (that is, managers of corporate planning departments and managers of personnel and labour affairs departments) agreed with this observation (24.7% and 25.9% respectively). Both sides agreed, however, that the management of Japanese companies had made progress in implementing achievement oriented and operating performance systems. Further, the view was expressed that the remuneration for executives had not significantly been changed (for example, stock options had not been introduced frequently). In relation to the life-long employment system, both sides recognised that it would become difficult to maintain this practice (i.e. 50.6% of managers of corporate planning departments, 49.6% of managers of personnel and labour affairs departments and 43.% of labour representatives) (Shakai Keizai Seisansei Honbu, 2001).

Based on the questionnaire survey on corporate governance conducted in 2001 *Roushi Kankei Tokubetsu Iinkai* (Labour-Management Relations Special Committee) published its interim recommendations on 12 December 2002. The interim recommendations referred to the U.S. corporate governance system as an external governance system, which was characterised by aiming at shareholder-oriented management and appointing non-executive directors, whereas they referred to the Japanese corporate governance system as an internal governance system, which was characterised by an emphasis on employee-oriented management. The interim report argued that the Japanese system had come under pressure to change in the context of globalisation. The interim recommendations also suggested that the Japanese corporate governance system should have aimed at harmonising both systems, the Japanese as well as the Anglo-American system, so as to correspond with the interests of both stakeholders and shareholders. The recommendation pointed out that the traditional Japanese internal governance system had been weakened recently, and suggested that it was therefore important to revitalise the Japanese style internal governance system in order to achieve a balanced governance system, which would constitute a synthesis of the U.S. system and the Japanese system.

The recommendation claimed that labour-management cooperation and active participation of employees were vital for a process aimed at revitalising the Japanese style internal governance system. It was recommended that, through a strengthening of labour-management consultations labour-management relationships should be established. And, there should be a striving for the sound development of companies in the long term (Shakai Keizai Seisansei Honbu, 2002a).

The final recommendations, published on 31 July 2003, argued that the Japanese corporate governance system had moved towards the U.S. style corporate governance system with its attention to shareholder wealth maximisation. Like the interim recommendations, which had been published in the previous year, the final recommendations advocated that companies should think highly of their employees and that it was important to achieve a balance between shareholder value and employee interests in the case of the Japanese corporate governance system. They further recommended restructuring of the labour-management relationship and the utilisation of the labour-management consultation system in all instances, as this was important for the Japanese corporate governance system (Japan Productivity Center, 2003). The final recommendations concluded:

> "Employees are the very source and important stakeholders of corporate activities. Allowing them to participate in corporate management and raising their willingness to work are keys to improving productivity. This is another reason why the function of collective labor-management relations must be reorganized and strengthened so that it can more readily adapt to changes in corporate management and new issues in labor-management relations accompanying those changes. In any age, issues arising from changes in corporate management require efforts of both labor and management. The importance of settling problems within the framework of collective labor-management relations remains unchanged (Japan Productivity Center, 2003).

6.2.4. Keizai Doyukai (Japan Association of Corporate Executives)

Keizai Doyukai (Japan Association of Corporate Executives) was established in 1946, one year after the end of the Second World War, by eighty three individuals from medium-sized enterprises. The aim of setting up the Association was to contribute to the rebuilding of the Japanese economy and its sound development. *Keizai Doyukai* is 'a nonprofit, private, nonpartisan organization'. The members of the Association participate in the Association as private persons, and not as managers of their respective companies. It is the objective of the Association to discuss and exchange opinions on broad economic issues happening at home and overseas. *Keizai Doyukai* has conducted studies on various issues and holds that its opinions impact upon Japanese society as a whole. The organisation ostensibly maintains its independence and discusses with political parties, authorities, and labour unions without being constrained (*Keizai Doyukai*, 2009).

Keizai Doyukai has published *Kigyō Hakusho* (White Paper on Business) at random times. In a White Paper on Business in 1996, it stated that Japan had been faced by a period of reforms that were equivalent to the revolution of the latter half of the nineteenth century that Japan had experienced in its history. *Keizai Doyukai*, reflecting its status as an association of corporate presidents, made various proposals from the viewpoint of management. They discussed corporate governance in their White Paper, stating that Japanese companies should recognise that a company can only survive with the support of its various stakeholders. They suggested that companies therefore needed to change their corporate governance systems, which were characterised by a significant concern for their employees. They also highlighted the importance of disclosure in order to enhance transparency and fair business practices in compliance with market principles. In relation to disclosure they expected that external stakeholders could be actively involved in the external monitoring system through the sharing of information through timely and continuing disclosure.

Keizai Doyukai (Japan Association of Corporate Executives) recognised the need to reform the board of directors, the board of corporate auditors and the role of the corporate auditor. In their White Paper they listed the following problems in relation to the board of directors that needed attention: first, large board size; second, lack of independence from senior management because most of the members of the board of directors were internally promoted; third, as important decisions were made in the council of general executives, the board of directors had lost in significance; fourth, insufficient recognition by the board members that they had been chosen to represent the shareholders of the company. The White Paper suggested that companies should introduce remuneration plans such as stock options in order to align corporate executives' interests with shareholder interests. Further, the White Paper also recommended a reduction in the number of members of the board of directors and an introduction of non-executive directors who would offer experience and ideas different from those of the internally promoted members of the board of directors, which in turn would enhance the self-check system. Proposals were also made for the reform of the board of corporate auditors and the role of the corporate auditor. The White Paper expected corporate auditors to take on an important monitoring function and thus recommended the development of an environment that would facilitate the activities of corporate auditors. Proposals here included, for example, enhancing the number of staff who support corporate auditors, giving corporate auditors the right to attend important meetings and to have one-on-one meetings with the top management. It was also recommended to appoint not only accountants and lawyers but also experienced business persons who held leadership positions in other companies as external auditors (*Keizai Doyukai*, 1996).

In 1998, *Keizai Doyukai* (Japan Association of Corporate Executives), published the 13th *Kigyō Hakusho* (White Paper on Business), which acknowledged that the world had become a global economy. In light of this development it was thus vital for Japan to move towards a market oriented economy and for Japanese companies to adopt capital efficiency management. The White Paper recommended that companies should appoint two non-executive directors, to review and strengthen the board of corporate auditors and the role of the corporate auditor, to establish unique customised corporate governance systems and to enhance transparency in management, which had already been stated in a previous White Paper on Business. *Keizai Doyukai* argued that the corporate governance system was influenced by culture, the size and business category of the corporation and that it was therefore desirable that laws and regulations would remain minimal and that companies should be entrusted with self-regulation. The White paper also called for further disclosure.

In addition it was pointed out that shareholders should assume a responsible role (for example, shareholders should hold shares for a long time). In terms of employment practices, it was argued that the environment in which Japanese businesses operated had changed and as a result of these changes it was necessary for Japanese companies to introduce more flexible employment practices so as to be able to compete globally (Keizai Doyukai, 1998).

In 2002, *Keizai Doyukai* (Japan Association of Corporate Executives) made a proposal for the corporate governance system of Japanese companies. This proposal was an extension of the previous two *Kigyō Hakusho* (White Paper on Business) published in 1996 and 1998 respectively (see above).

Kigyō Hakusho (White Paper on Business) published in 2003 focused upon corporate social responsibility (CSR). The main concern had now shifted to corporate governance in line with corporate social responsibility. The White Paper stated that the purpose of the corporate governance system was to ensure that companies could develop themselves firmly and sustainably. It was argued that in order to achieve such an objective it was vital for companies to fulfil their social responsibility. In other words, fulfilling their corporate social responsibilities would enable companies to sustainably grow, which would be in line with the purpose of establishing corporate governance (Keizai Doyukai 'Kigyō Keiei Iinkai', 2003).

The White Paper emphasised the role of top management in providing strong leadership in the context of change and in providing clear guidance to the employees of the company. Further, the White Paper recommended that the board of directors should separate out the function of execution of duty from the monitoring function. That would remedy the current practice of concentrating power at the level of top management, which makes it difficult for members of the board of directors to act as agents for shareholders in preventing misconduct by top management. This recommendation reflected *Keizai Doyukai's* concerns (Japan Association of Corporate Executives) about recurring corporate scandals in Japan, which had lowered confidence in and the competitiveness of Japanese companies. It therefore recommended that companies maintain their soundness and compliance with related laws. Like previously published recommendations by *Keizai Doyukai* (Japan Association of Corporate Executives), the 2003 White Paper also stressed the importance of disclosure and communication with stakeholders. It was further argued that companies should take stakeholders into consideration so as to achieve an increase in shareholders' wealth in the long term and not only pursue short term profit (Keizai Doyukai 'Kigyō Keiei Iinkai', 2003).

In 2004, *Keizai Doyukai* (Japan Association of Corporate Executives), conducted a questionnaire survey on corporate governance. The results of this survey show that about 94% of the respondents recognised corporate governance as an "important business challenge" (*Keizai Doyukai*, 2004). The survey also revealed that only 7% of companies had adopted the U.S. style corporate governance system with subcommittees consisting mainly of non-executive directors, whereas 93% of the respondents still reported the adoption of the traditional Japanese corporate governance system. The survey showed that companies that had chosen the traditional Japanese corporate governance system had introduced non-executive directors and the corporate officer system. Interestingly, only 3% of the companies that followed the Japanese corporate governance system intended to change over to the U.S. (or Anglo-American) corporate governance system. Around 44% of the other companies did not plan to move towards the U.S. board of directors system or were thinking which system to chose or adopted a wait-and-see attitude. Those, who had switched to the U.S. system, saw the change as positive, whereas 47% of the respondents surveyed reserved their judgment. 56% of the respondents were positive about serving as a non-executive director, although 44% of the respondents had a negative attitude about this matter *(ibid.)*.

After the series of these recommendations published between 1996 and 2004 (see above), *Keizai Doyukai* (Japan Association of Corporate Executives) published its proposals on the new Japanese style management in 2008. These proposals reflected previous proposals in that they advocated advancing communication with stakeholders and the utilisation of non-executive directors. These proposals again reflect the tendency evident in previous proposals to recommend changes to the Japanese corporate governance system, which were in line with the Anglo-American corporate governance system. The 2008 proposal are, however, of particular interest as they discuss some aspects of traditional Japanese management practices in a way that begins to question the appropriateness of applying the Anglo-American model of governance to the Japanese context. Life-long employment, a management practice that sustained the Japanese corporate governance system, was seen in the proposals as being an advantage in enhancing the long-term growth of a company. Further, it was also acknowledged that to a certain extent seniority based employment practices also can serve corporate success. And, the proposal highlighted the role of labour unions as a partner of management (Keizai Doyukai, 2008). The 2008 proposal had thus begun to move away from the view that Japanese companies should follow the U.S. style corporate governance system if they wanted to increase their competitiveness in the global market. This change in view is part of a general trend in Japan since the end of Prime Minister Koizumi's term in office when politicians as well as the public had begun to critically reflect upon the liberalisation attempts from the late 1990s to 2005 and the view had emerged that liberalisation had gone too far .

6.2.5. Kigyō Nenkin Rengokai (Pension Fund Association)

Kigyō Nenkin Rengokai (Pension Fund Association) was originally established in 1967 as 'a federation of employees' pension fund, based on the Employee Pension Insurance Act and the Pension Fund Association in its present form was established under the revision of the Act in 2004' (Kigyō Nenkin Rengokai, 2009; Pension Fund Association, 2009a). *Kigyō Nenkin Rengokai* (Pension Fund Association) manages effectively its assets for those 'who seceded from employees' pension funds after a short period (usually less than 10 years) of membership (midway seceders) in an integrated manner, and undertakes the aggregation of different corporate pension plans, including employees' pension funds, defined benefit corporate plans and defined contribution plans' (Pension Fund Association, 2009a).

Kigyō Nenkin Rengokai (Pension Fund Association) has published several *Corporate Governance Principles*, namely, in 2003, 2006 (revised version) and 2007. There were some additional issues addressed in the *Corporate Governance Principles* of 2007 the basic stance on corporate governance, however, was the same in 2007 as before. In the *Practical Guideline on the Exercise of Shareholder Voting Rights* published in 2003 and the *Corporate Governance Principles* published in 2007, *Kigyō Nenkin Rengokai* (Pension Fund Association) commented on corporate governance, stating that: '… what is of utmost importance is to forge a system within the company to monitor company management from the standpoint of shareholder value' (Pension Fund Association, 2009b). Based on this perspective, *Kigyō Nenkin Rengokai* (Pension Fund Association) referred to the board of directors, the board of corporate auditors, disclosure and accountability, executive remuneration, dividend policy, changes in management strategy, corporate social responsibility and the responsibility of *Kigyō Nenkin Rengokai* (Pension Fund Association) as a shareholder.

In the *Corporate Governance Principles* (2003), the Association required companies to separate the execution function and the monitoring function of the board of directors and to monitor the Chief Executive Officer on behalf of the shareholders.

They further remarked that the board of directors should be of an appropriate size. It was recommended that at least one third of the members of the board of directors should be non-executive directors. Further it was stated that it was desirable for the CEO not to have a dual role, which means not to take on the chairpersonship of the board of directors. *Kigyō Nenkin Rengokai* (Pension Fund Association) supported the U.S. style corporate governance system with sub-committees consisting of mainly non-executive directors (Kigyō Nenkin Rengokai, 2003). In the case of corporate auditors, the association emphasised that corporate auditors should remain independent from the company for which they work. The association also expected corporate auditors not only to conduct 'the legality of but also, on a deeper level, the propriety of the decisions rendered and business executed by company management' (Pension Fund Association, 2009b; Kigyō Nenkin Rengokai, 2009b).

The Association encouraged CEOs to disclose information on business activities so as to fulfil their duty of accountability to shareholders and other stakeholders and urged CEOs to supply the board of directors and the audit committee with information, which is sufficient for them to judge the adequacy of the CEO's business judgment.

The association recommended that companies introduce monetary incentive packages for their executives, which were linked to long term shareholder value. Companies were also urged to disclose individual executive remuneration arrangements. The association advised companies to balance executive remuneration with company earnings and dividends paid to its shareholders. In terms of dividend policy it was recommended that companies should decide the dividend policy from a medium- to long-term perspective. Companies that did not have adequate future business plans and had reserved residual profit more than was deemed necessary were urged to ensure an appropriate dividend level (Pension Fund Association, 2009b; Kigyō Nenkin Rengokai, 2009b).

The association also required management to give adequate information to shareholders in a context where the company was changing its business strategy so as to enable shareholders to make correct decisions. Further, it was argued that management should get the approval of shareholders before making important decisions in terms of changes to their business strategy. The association also expected companies to be good corporate citizens and to establish a good relationship with its stakeholders such as, for example, employees, business partners and the community where the company was located. Further, the association urged companies to ensure compliance with the law and with business and corporate ethics. Finally, the association announced that it was prepared to positively engage in dialogue with companies it had invested in as a stable and long-term shareholder (Pension Fund Association, 2009b; Kigyō Nenkin Rengokai, 2009b).

In the revised version of the Principles, which was published in 2006, several issues were added. First, a section on accounting auditors[77] was added, which stressed that accounting auditors must be independent from the client company and be able to prove it. The company should also respect the opinions of the Audit Committee when the accounting auditors are chosen. Second, a new issue, which is related to the business plan, was that the association recommended that companies should be aware of the cost of shareholders' equity. It was thus recommended that the return on equity (ROE) should ideally be over 10%. Third, the association also added an item, which related to the role of the association as a shareholder and declared that '[i]n particular, the PFA will engage in dialogue with companies whose earnings and/or shareholder value have been underperforming over a long term and which are deemed to be lacking in proper corporate governance' (Pension Fund Association, 2009b).

Kigyō Nenkin Rengokai (Pension Fund Association) set up the *Employees' Pension Fund Corporate Governance Forum* in order to ensure that the corporate governance system of Japanese companies focuses on shareholder value and published a recommendation on *Kigyō nenkin to Koporeito Gabanansu –Kabunushi Kachi no Saidaika ni Mukete-* (Corporate Pension and Corporate Governance) in 2004 as a result of a series of research studies by the association. The recommendation stated that the corporate purpose was to maximize shareholders` wealth in the long-term. It emphasised, however, that this purpose did not conflict with a consideration of other

[77] In Japan accounting auditors are those auditors who carry out the external audit. Internal audits are carried out by corporate auditors.

stakeholders as it was impossible for companies to be successful in the long-term without having a good relationship with various stakeholders. Further, the recommendation supported the exercising of voting rights as a duty of shareholders and required companies to establish corporate governance systems, which separated the execution function from the monitoring function of the board of directors, appointed non-executive directors, implemented disclosure requirements and encouraged management engagement, which all would ensure the maximisation of shareholders' wealth in the long-run (*Kigyō Nenkin Rengokai*, 2004).

6.2.6. Nihon Kansayaku Kyokai (Japan Corporate Auditors Association)

Nihon Kansayaku Kyokai (Japan Corporate Auditors Association, JCAA) was founded in 1974 as a result of the amendment of the *Commercial Code* to 'strengthen the authority and independence of Corporate Auditors' (Japan Corporate Auditors Association, 2001a). Since its establishment, JCAA has been active in research and studies so as to 'develop and promote the Corporate Auditors system' (*ibid.*). JCAA currently has 'about 4,000 corporate members and about 6,000 registered Corporate Auditor's (*ibid.*). Corporate auditors are called "*Kansayaku*" in Japanese and they are peculiar to Japan. According to JCAA, "*Kansayaku*" (corporate auditors) is defined as 'different from internal compliance or accounting/audit managers, who are ordinary employees of the company with less authority, and reporting to the Shareholders' (Japan Corporate Auditors Association, 2001b). *Kansayaku* (corporate auditors) are appointed by the company's shareholders at the Annual General

Meeting (AGM) and they play a role in the 'Horizontal Two-Board' (*ibid.*) structure of Japanese companies.

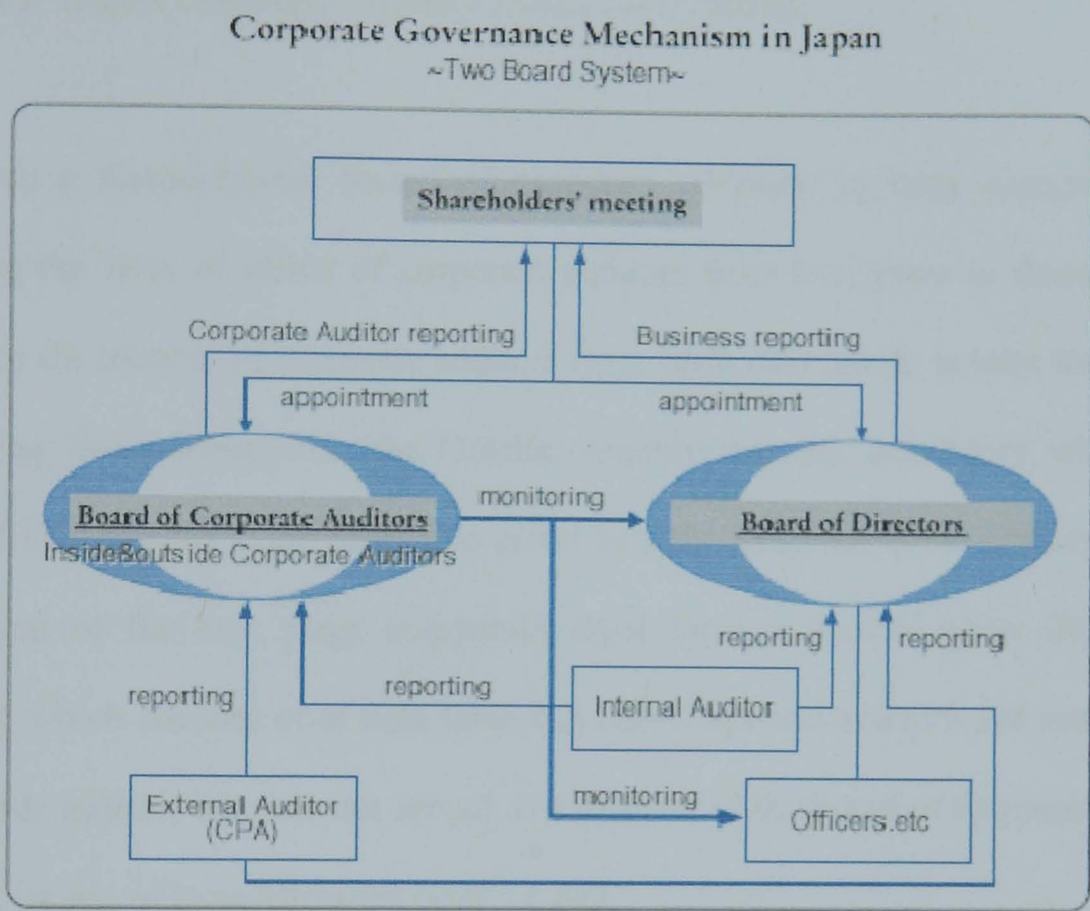

Figure 2: The Role of the Board of Corporate Auditors in the Japanese Two Board System[78]

The function of *Kansayaku* (corporate auditors) is broadly equivalent to the audit committee, which is applied in the Anglo-American style of corporate governance system. There are, however, some important differences, such as, for example, that corporate auditors conduct a "'business audit' and a 'financial audit'", [79] and they are

[78] Figure 2 is from the Association's web-site (http://www.kansa.or.jp/english/about_sub-w.html).

[79] JCAA explains 'business audit' and financial audit' as follows: 'A business audit is an assessment of whether or not the directors are correctly observing applicable laws and the company's charter provisions while managing the company, and is commonly referred to as a 'compliance audit'. A financial audit is conducted before the financial statements are submitted to a shareholders' annual meeting. The audit report, which contains the results of both the financial and business audits, must accompany the notice of the shareholders' meeting. Consolidated financial statements are also subject to auditing by kansayaku, and the results of the audit must be reported at the annual shareholders' meeting' (Japan Corporate Auditors Association, 2001d).

a body separate from the board of directors. JCAA holds that *Kansayaku* (corporate auditors) are an '[e]ssential functioning part of Japan's Corporate Governance framework' (Japan Corporate Auditors Association, 2001b).

Setting up a *Kansayakukai* (board of corporate auditors) in large companies[80], extending the term of office of corporate auditors from two years to three years, increasing the number of corporate auditors from more than one to at least three and introducing *Shagaikansayaku* (the Outside Auditor) became mandatory when the amended *Commercial Code* came into effect in 1993 (Ikejima, 1994). Through this amendment of the law, large companies must form a *Kansayakukai* (board of auditors), which consists of at least three full-time corporate auditors and more than one outside auditor, who has not served as a member of the board of directors of this company or one of its subsidiaries (*ibid.* , p.82).

JCAA published their first pronouncements on corporate governance in 1996. Reflecting the nature of the association, their area of discussion of corporate governance was auditing and the auditor within the framework of the corporate governance debate. In their pronouncements, JCAA presented issues, which they felt could be improved, that is, the composition of the board of corporate auditors, the appointment of outside corporate auditors and communication issues between corporate auditors and top management.

[80] The definition of a large company according to the *Commercial Code* is: '...the statute as a joint-stock company having legal capital of 500 million yen or more or total balance-sheet liabilities of 20 billion yen or more' (Japan Corporate Auditors Association, 2001d).

JCAA made several suggestions concerning improvements of the board of corporate auditors. It stressed the central role of full-time external auditors on the board of corporate auditors and recommended improved communication and sharing of information with outside corporate auditors in order to facilitate the role of the outside corporate auditors. JCAA, however, did not recommend that outside corporate auditors would hold positions with other companies even if he or she was only appointed in a part-time role because of the significant responsibility attributed to outside corporate auditors. JCAA advised that corporate auditors should have better communication with top management and the executives of the company. It also recommended that corporate auditors should be able to attend the executive board as it was the *de facto* decision-making body of the company. And, it was suggested that companies should supply their corporate auditors with a sufficient number of support staff (Kansa Seido Iinkai, 1996).

JCAA has published various research studies since 1996. In 2000 the association released an *Interim Report* on future perspectives on laws, especially the *Commercial Code* and corporate governance issues. The report made ten recommendations. It is of interest that the report defined the objective of a company as making benefits from business activities in order to meet the requirements of its various stakeholders with its basic principles being sound management and effectiveness. In order to achieve these principles, it was argued that it was crucial for companies to reconsider their organisational structures and clarify the powers and responsibilities of the members of the board of directors and the corporate auditors. Further, it was suggested that it was important to have flexible laws governing the activities of companies so that they would be able to appropriately deal with the changing business environment. Thus, for the case of the corporate auditors, the JCAA recommended that it was preferable to flexibly manage the corporate auditor system within the existing legal system rather than implementing further regulations such as, for example, effectively augmenting the personnel of outside auditors. The JCAA also recommended that the law should allow companies to either adopt the traditional Japanese corporate governance system with its board of corporate auditors or the Anglo-American style of corporate governance system with the monitoring function being with the non-executive directors. It further advised to reconsider corporate governance systems in the context of managing a corporate group, for example, in the context of the management of subsidiary companies. JCAA also advocated that companies should improve the quality of auditing and enhance disclosure especially of human resource management issues in relation to members of the board of directors. It was also suggested that the remuneration systems of executives and the class law suit system should be reconsidered and the Annual General Meeting (AGM) be revitalised. Finally, JCAA recommended that companies should take into account the different interests of their shareholders, for example, shareholders who hold shares in order to make profit in the short-term and those who intend to hold shares in the long-term. Considering various shareholders is important in the context of the company having to maximise shareholder wealth and JCAA thus suggest that companies take effective steps to ensure that they look after the interest of all their shareholders

(Nihon Kansayaku Kyokai, 2000). JCAA was aware of the need for independence of corporate auditors and therefore argued that it was desirable that the candidates for the position of corporate auditors should be approved by the board of corporate auditors before they are proposed for approval by the Annual General Meeting (AGM).

JCAA carried out joint research with academics into the role of outside auditors in corporate governance in Japan. The report, which was published in 2007, stated that Japan had been affected by the expansion of globalisation, which it understood as coming from the U.S. Influenced by contextual and political circumstances, a series of amendments of the *Commercial Code* had taken place since 1993, which reflected U.S. laws. With the growing concern about corporate governance and the political pressure from the U.S. the corporate auditor system had thus been amended since 1990s. According to the report, the Japanese government had attempted to complete the arrangement for corporate governance by strengthening the authority, responsibility and role of corporate auditors and not by introducing and strengthening non-executive directors. Further, the report argued that in order to respond to the pressure from the U.S. and globalisation more generally, qualifications of outside auditors have been tightened. Of significance in this context was the revision of the *Commercial Code* in 2002. The revised law now allowed Japanese companies to either choose the traditional Japanese corporate governance system with its board of corporate auditors, which now has to be dominated by outside auditors, or the Anglo-American style corporate governance system. The report pointed out that the majority of Japanese companies still maintained the traditional Japanese corporate governance system in 2007, which meant that outside auditors in Japan were expected to carry out the responsibilities of non-executive directors in the Anglo-American corporate governance system, such as auditing the appropriateness and efficiency of business judgements made by management. In this context it was important to provide suitable environments so that outside auditors can properly fulfil their duty and central role in corporate governance. In order to achieve such an environment, the report suggested that several issues had to be reconsidered. The report stressed that, when selecting outside auditors, management should recognise that corporate auditors and the board of corporate auditors were not just an insignificant body but that they had an important monitoring role. At the same time, outside auditors should be aware of their significant duties and responsibilities and the need of being independent from the management and the board of directors. This is crucial, the report argued, in order for corporate auditors to be able to make adequate judgements of the activities of management. The report recommended that outside auditors should also offer their opinions on top management and their business activities. Further, it was suggested that outside auditors should assume the position of somebody outside of the company and maintain an objective view. Outside auditors should become familiar with the company concerned and should cooperate with corporate auditors and their support staff and attempt to support the board of corporate auditors (Nihon Kansayaku Kyokai Kansaishibu, 2007).

6.2.7. Nihon Kouninkaikeishi Kyoukai (The Japanese Institute of Certified Public Accountants, JICPA)

The *Japanese Institute of Certified Public Accountants* was established in 1949 as 'a self-disciplinary association and reorganized under the Certified Public Accountants Act in 1966. In order to practice as a CPA, a qualified person must register with the JICPA and join its membership' (The Japanese Institute of Certified Public Accountants, 2009a). The JICPA engages in a whole range of activities, including self-regulation and offering membership services. One of its activities that is of special interest here is '[p]roviding guidance on auditing, accounting and other related professional services and submitting comments on various exposure drafts published by other organizations' (*ibid.*). Interestingly, despite this emphasis on providing guidance and comment the JICPA has not been significantly engaged in the corporate governance debate during the period under consideration here (i.e. from 1989-2007). A likely explanation for this is that the JICPA did not consider the key issues discussed in the corporate governance debate as particularly relevant to their activities. That is, external disclosure and the auditing of this disclosure were not discussed at a level of detail that would have either needed the input of the JICPA or would have significantly impacted upon the work traditionally done by the members of the JICPA. During 1989 to 2007, the JICPA was involved in the process of aligning Japanese accounting standards with *International Accounting Standards*

(IAS) and *International Financial Reporting Standards* (IFRS).[81] The changes to accounting have, however, not attracted the attention of the corporate governance debate and were implemented with little controversy and the support of *Nippon Keidanren*. Interestingly, *Nippon Keidanren* did not see accounting and accounting disclosure as a controversial issue but saw this as an area that could significantly contribute to the success of Japanese businesses. *Nippon Keidanren* thus stressed that they 'fully support the acceleration of convergence of accounting standards among the IFRS, U.S. and the Japanese GAAP' (Nippon Keidanren, 2006). In the context of the above it was only in 2007 that the JICPA showed an interest in corporate governance when it established a project team in anticipation of a possible revision of the Companies Act in November 2007. According to JICPA, '[t]he project team considered the role of corporate governance from a wide range of perspectives, including who should appoint accounting auditors and determine audit fees, and how the disclosure and audit system should be improved under good corporate governance from a mid- and long-term perspective' (The Japanese Institute of Certified Public Accountants, 2009a). The JICPA issued a report entitled "Role of Corporate Governance and Disclosure by Listed Companies", which was aimed at improving the credibility of the financial information of listed companies in May 2009 (*ibid.*).[82]

[81] The JICPA is a founding member of the International Accounting Standards Committee (The Japanese Institute of Certified Public Accountants, 2009b).

[82] This report, which was published in 2009, falls outside of the period under focus here, i.e. 1989-2007. A detailed analysis of this report is therefore not provided.

The above summary of the views of some of the key Japanese constituencies in the debate over corporate governance has brought out different positions in relation to how the pressure to change the Japanese corporate governance system had been perceived. The *Tokyo Stock Exchange* in their pronouncements reflected the Anglo-American corporate governance model in their pronouncements on corporate governance. Their concern was with shareholders, which is in line with other stock exchanges. *Nippon Keidanren*, as the association of business, expressed especially a concern with the competitiveness of Japanese businesses in a global context. This is not surprising given the type of organisation *Nippon Keidanren* is. In their pronouncements on corporate governance, they generally supported the revisions of the law, especially the strengthening of the auditor system and the board of directors. The JPC-SED, an organisation that brings together academics, labour representatives and business people, took a different stance from the above constituencies. It was especially concerned about the employer-employee relationship in the context of the proposed changes and developments of corporate governance in Japan. This is because they view employees as particularly important stakeholders that significantly contribute to the success of the company. They thus suggested that employees should collaborate with employers in developing a Japanese corporate governance system. In addition, they expressed a concern about consumers. Interestingly, there is no reference in their pronouncements to shareholders and shareholder interest and rights.

Kigyō Nenkin Rengokai (The Pension Fund Association) made several pronouncements on corporate governance. Given the character of the association it stressed shareholders and was concerned that shareholder interests were pursued by management and that appropriate monitoring mechanisms were put in place. The issues addressed by *Kigyō Nenkin Rengokai* reflected key concerns of the Anglo-American corporate governance system. *Nihon Kansayaku Kyokai* (Japan Corporate Auditors Association) mainly focused on the board of corporate auditors that is part of the Japanese corporate governance system. Their concern was to make recommendations that would strengthen the role of the internal auditor as well as making sure that internal auditors are appropriately qualified and independent from the company's decision makers.

The organisations discussed above are key constituencies in Japan that contributed to the corporate governance debate. All these constituencies were established before the period under focus here and their main objectives are the representation of the interests of their members in policy debates and providing services to their members. These organisations engaged in the corporate governance in Japan debate because they perceived that a good corporate governance system would be of benefit to their members or they were generally interested in the outcomes in relation to this system. Their engagement was carried out within the existing frameworks of their organisations. In addition to these organisations, there is another Japanese organisation that significantly contributed to the corporate governance debate but that is different in several ways form the above organisations, namely, the *Japan Corporate Governance Forum*. The *Japan Corporate Governance Forum* is a private organisation consisting of academics, business people, lawyers and journalists that was founded in October 1994 motivated by an interest in the establishment of a sound corporate governance system for Japanese companies. The Forum issued its own *Corporate Governance Principles* in 1998, which they hoped would set the standard for 'good' corporate governance. These Principles received international recognition, most notably from CalPERS. The work of the *Japan Corporate Governance Forum* is of particular interest as it was an attempt at self-regulation, which was a new development in the Japanese context in which accounting and companies have traditionally been regulated by the law. Further, in contrast to the constituencies discussed above, the *Japan Corporate Governance Forum* was established in response to global pressure to change the Japanese corporate governance system and to what was perceived to be a corporate governance failure in Japan[83] with the particular objective of establishing a set of principles that would constitute good corporate governance practice for Japanese companies. It is of note that the *Japan Corporate Governance Forum* does not represent the interests of a particular group, such, as for example, business or corporate auditors, but is a collection of individuals that got together to deal with the corporate governance issue. The *Corporate Governance Principles* thus do not represent the view of one single constituency but the shared view of a collective of people that have arrived at their shared position through debate and consultation with other interested groups. Because the *Japan Corporate Governance Forum* is different - as outlined above - from other constituencies in Japan it has been chosen as a focus for one of the case

[83] The 1990s witnessed increased fraud and corporate failures.

studies here. The various versions of its *Corporate Governance Principles* published between 1997 and 2006 constitute the empirical material focused upon in Chapter 8.

6.3. KEY TRENDS AND ISSUES IN THE PUBLIC DEBATE ON CORPORATE GOVERNANCE IN JAPAN

In the following, the results of a content analysis of a sample of Japanese specialist financial and general newspapers are summarised in order to provide more insights into the growing public debate on corporate governance.[84] An appreciation of how the debate developed and what the key issues of the debate were is important for an understanding of the empirical material that forms the two case studies of chapters 7 and 8.

The academic literature on corporate governance in Japan has referred to an emerging concern about the Japanese corporate governance system during the 1990s (see, for example, Aoki et al, 2008). There are different opinions as to when the term corporate governance was first mentioned in the media with researchers suggesting two key dates, 1991 and 1992 (Yoshimori, 2003, p.204). The analysis of the newspapers here confirms that the term corporate governance emerged in the early 1990s. The term was first mentioned by *Nihon Keizai Shimbun* on 13 May

[84] The objective of the content analysis here is to provide some insights into the general trend of corporate governance reporting of Japanese newspapers so as to facilitate the analysis of the empirics in the case studies. The content analysis therefore does not offer a detailed analysis of all the corporate governance themes and issues that were addressed in the newspapers. Such a detailed analysis would go beyond the scope of this study here.

1991. *Nikkei Kinyu Shimbun* (*Financial Daily*) first referred to corporate governance on 15 July 1992. In the same year, 6 September 1992, the term appeared in *Asahi Shimbun*, one of the four general newspapers surveyed. By the end of 1993, corporate governance had featured in all but one of the seven newspapers surveyed. *Nikkei Sangyo Shimbun* (*Business Daily*) was the last of the seven newspapers to refer to corporate governance for the first time in 1994.

Analysis of the number of articles referring (at least once) to 'corporate governance' suggests three key periods in the reporting of corporate governance (Figure 3).[85]

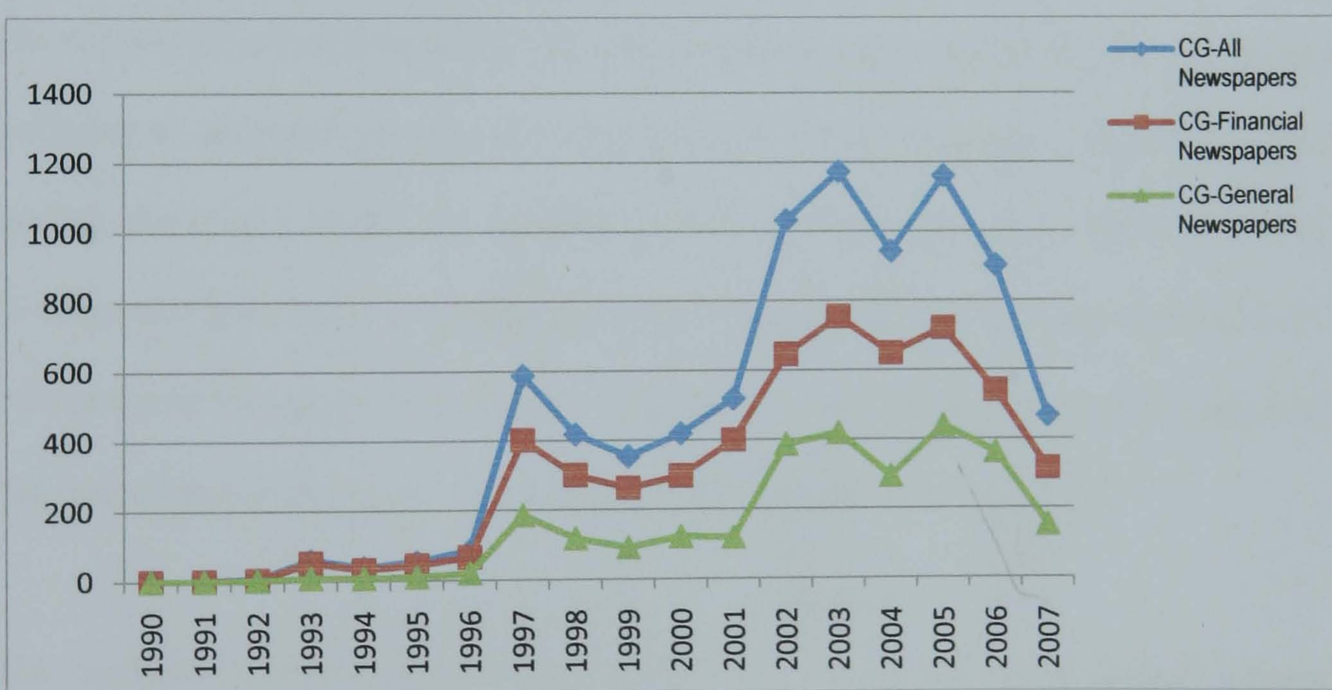

Figure 3: Corporate Governance Reporting in the Newspapers

[85] Only summary figures, which provide information relevant for the development of the argumentation, are included here. Figures, from which the summary figures have been derived from, are included in the Appendix.

As Figure 3 indicates, the three key periods were: first period, from 1996 to 1998 with the peak in the reporting in 1997; second period, from 2001 to 2004 with the peak in the reporting in 2003; and, third period, from 2004 to 2006 with the peak in the reporting in 2005. Until 1996 the reporting on corporate governance was not very significant. There was a small increase in the reporting in 1993 when the number of articles referring to corporate governance increased to 60 per year, the highest number between 1991 and 1995. During the first key period there was a steep increase in the reporting from 86 articles in 1996 to 588 articles in 1997. During the second period the increase was less sharp but during the peak of 2003 the number of articles reached 1173. This constitutes the highest number of articles referring to corporate governance during the period surveyed here. During the third period, the level of reporting reached its peak in 2005 with 1161 articles referring to corporate governance. Figure 3 indicates that although the volume of reporting[86] was lower in the general newspapers compared to that of the financial newspapers, the reporting of both types of newspapers followed the same trend.

The increase in corporate governance reporting during the above period reflects key contextual developments. A change of the *Commercial Code*, which became effective in 1993, had drawn attention to corporate governance issues especially through, for example, its simplification of shareholder lawsuits (Demise, 1997).

[86] During the period from 1 January 1990 to 31 July 2007, the general newspapers published 2737 articles that referred to corporate governance, whereas the financial newspapers published 5487 articles.

The significant increase in corporate governance reporting during the first key period reflects a new key direction in government policy. In 1996, the Japanese government had embarked on a deregulation programme, which covered the period from 1996 to 1998 (the so-called "Big Bang") (Hall, 1998, 139-158). The period from 2001 to 2004 saw debates over planned changes to the *Commercial Code* and the passing of the revised *Commercial Code*, which allowed companies to choose between the Japanese or Anglo-American corporate governance system. The revised *Commercial Code* had come into effect in 2003, the peak in the reporting during this period. During the third period, from 2004 to 2006, further amendments of the *Commercial Code* were discussed and implemented. Of significance here was the creation of a new *Companies Act*, which was passed by the Diet in 2005 and became effective in 2006. It was, however, not the introduction of the new Companies Act, which seems to have impacted significantly on the corporate governance reporting but some high-profile attempts at takeovers during this period, which achieved media attention in 2005. In the context of these takeover attempts, the most high-profile one being *Livedoor*[87], the *Securities and Exchange Law* was revised in 2005. This is evident from Figure 4, which shows the trends in the newspaper reporting on the *Commercial Code* and the *Companies Act* as well as the

[87] The Securities and Exchange Law was revised in order to clarify the scope of tender-offer rules. The issue had arisen because *Livedoor* had acquired around 35% of the outstanding shares of Nippon Broadcasting System 'in off-hour trading on ToSTNet-1 [Tokyo Stock exchange Trading network] of the Tokyo Stock Exchange' (Nagashima et al., 2005). According to Nagashima et al. (2005), 'Livedoor argued that the tender-offer rules did not apply to off-hour trading and, as such, it was not required to comply with tender-rules in its acquisition of shares of Nippon Broadcasting System'. The law was changed and tender-offer rules from July 2005 have to be complied with in off-hour trading if it is intended to acquire more than one-third of the outstanding shares of a listed company.

reporting on takeovers and the *Securities and Exchange Law* during the period surveyed.

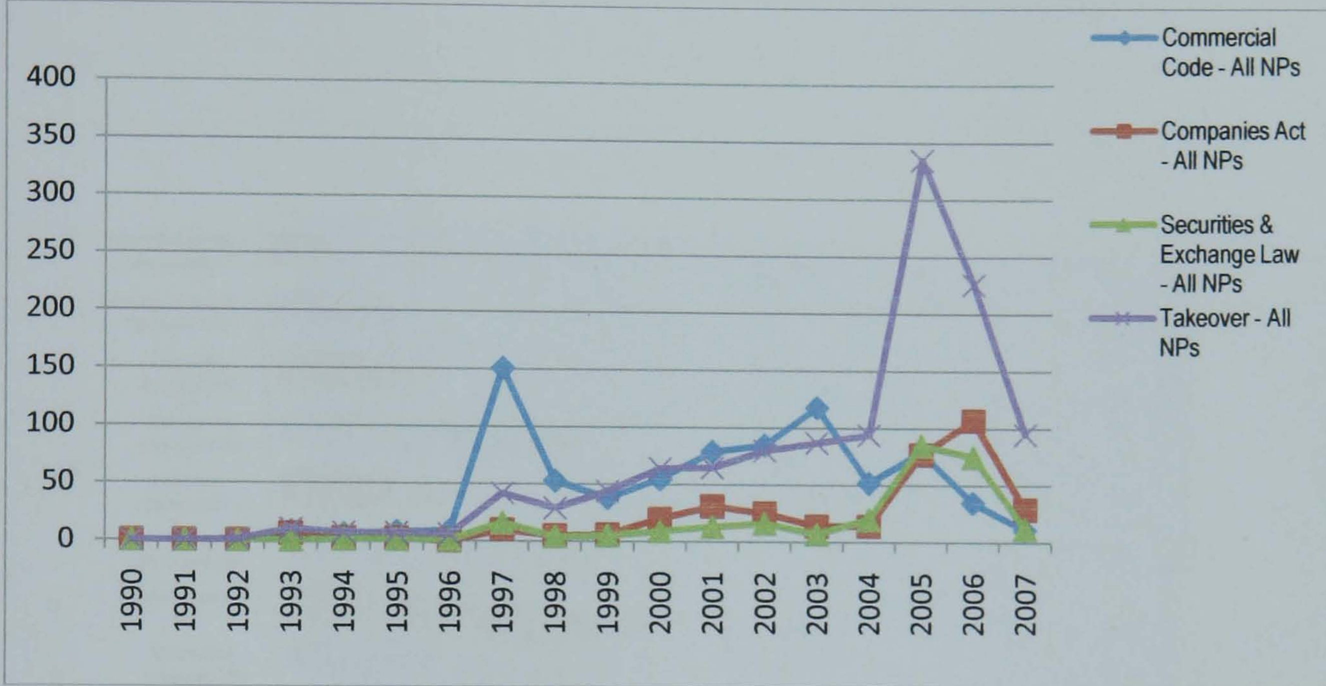

Figure 4: Reporting on Commercial Code, Companies Act and Takeovers in All Newspapers

It is of interest to explore, which particular components of the corporate governance system were most widely debated and reported on during the period from 1990 to 2007. Table 8 provides a summary of the reporting of the financial and general newspapers of the following five main components of the corporate governance system: the board of directors, disclosure, the audit, internal control and takeovers. Of the 10,031 articles referring to at least one component of the corporate governance system, 4,758 (that is 47.4%) refer to the board of directors. This is the most referred to corporate governance component for both types of newspapers. In the case of the financial newspapers, over half of the articles (51.3%) refer to the board of directors and in the case of the general newspapers 40.2% refer to it. Further, the data reveals that, in the case of the financial newspapers, the board of directors has constituted by far the biggest part of the reporting since 1991, with financial disclosure, audit and takeovers all being referred to in around 15% of the articles respectively. This, however, is different

Table 8: Reporting of Key Components of the Corporate Governance System, 1990-2007, Financial and General Newspapers

for the reporting of the general newspapers: 35% of the articles report on audit, 12% on disclosure and 11% on takeovers and only 1.5% on internal control. The least reported on component of the corporate governance system during the period surveyed here is internal control, with 3% of articles in the financial newspapers and 1.5% of articles in the general newspapers referring to internal control.

Content analysis has indicated that the most debated issue in the context of Japan being under pressure to change its traditional corporate governance system and to converge with the Anglo-American system was the board of directors. It is thus of interest to gain further insights into the reporting of issues related to the board of directors, such as non-executive directors, US-style board of directors and executive remuneration. As Figure 5 indicates, the reporting on the board of

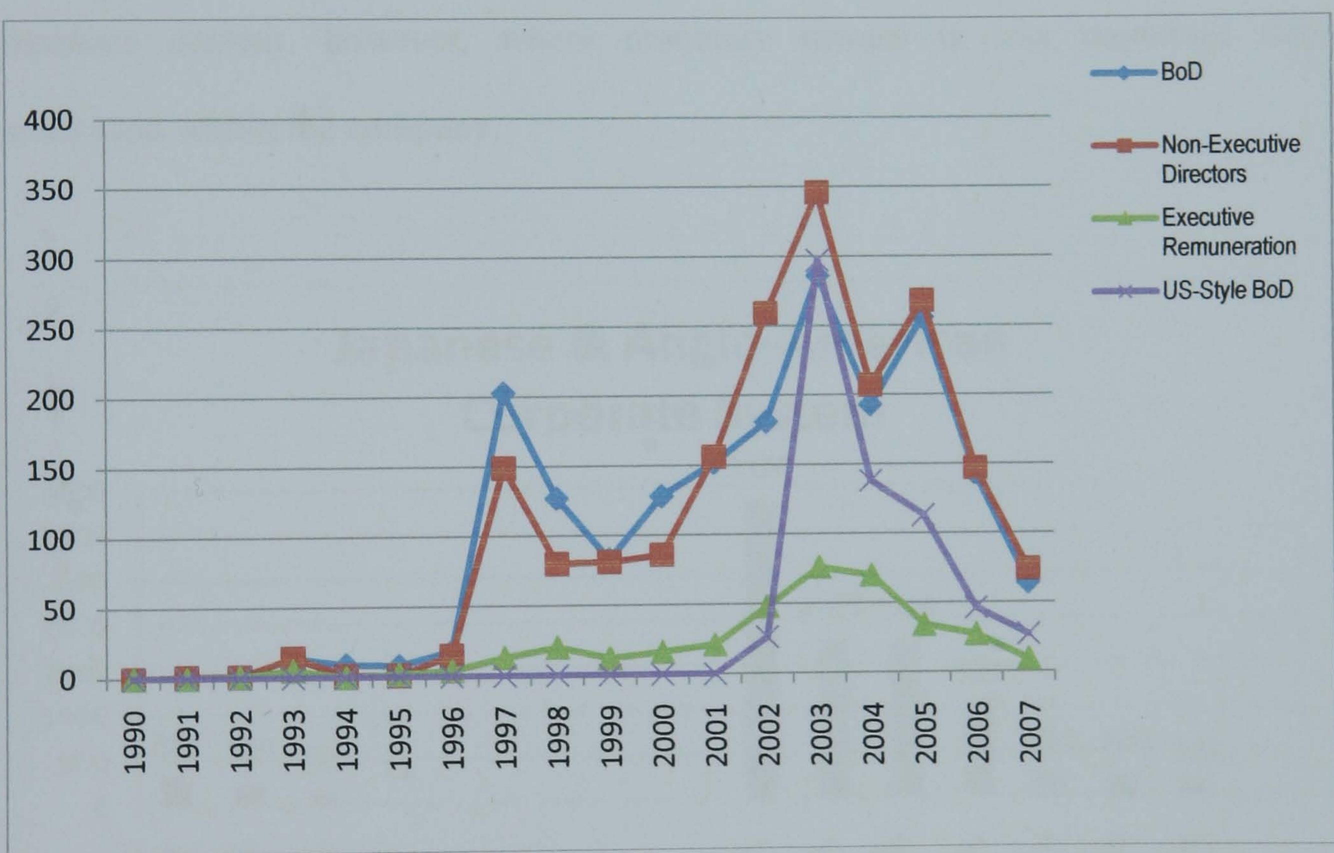

Figure 5: Reporting on the Board of Directors, Non-Executive Directors, Executive Remuneration and US-Style Board of Directors, All Newspapers in Sample

directors and related issues follows the same trend as the corporate governance reporting more generally. From Figure 5, it is also evident that, during the period from 1990 to 2007, articles nearly equally referred to the board of directors and non-executive directors, 1867 and 1886 articles respectively. From 2002 to 2003 there is a sharp increase in the reporting on US-style board of directors, which reflects developments in Japan, i.e. the amendment of the *Commercial Code* in 2003, which allowed companies to chose either the traditional Japanese corporate governance system or the U.S.-style corporate governance system with several sub-committees and an increased number of non-executive directors. From Figure 5 it appears that executive remuneration did not attract as much attention with only 7.5% of articles referring to executive remuneration. This is not surprising in the Japanese context, however, where monetary reward is less important than promotion within the company.

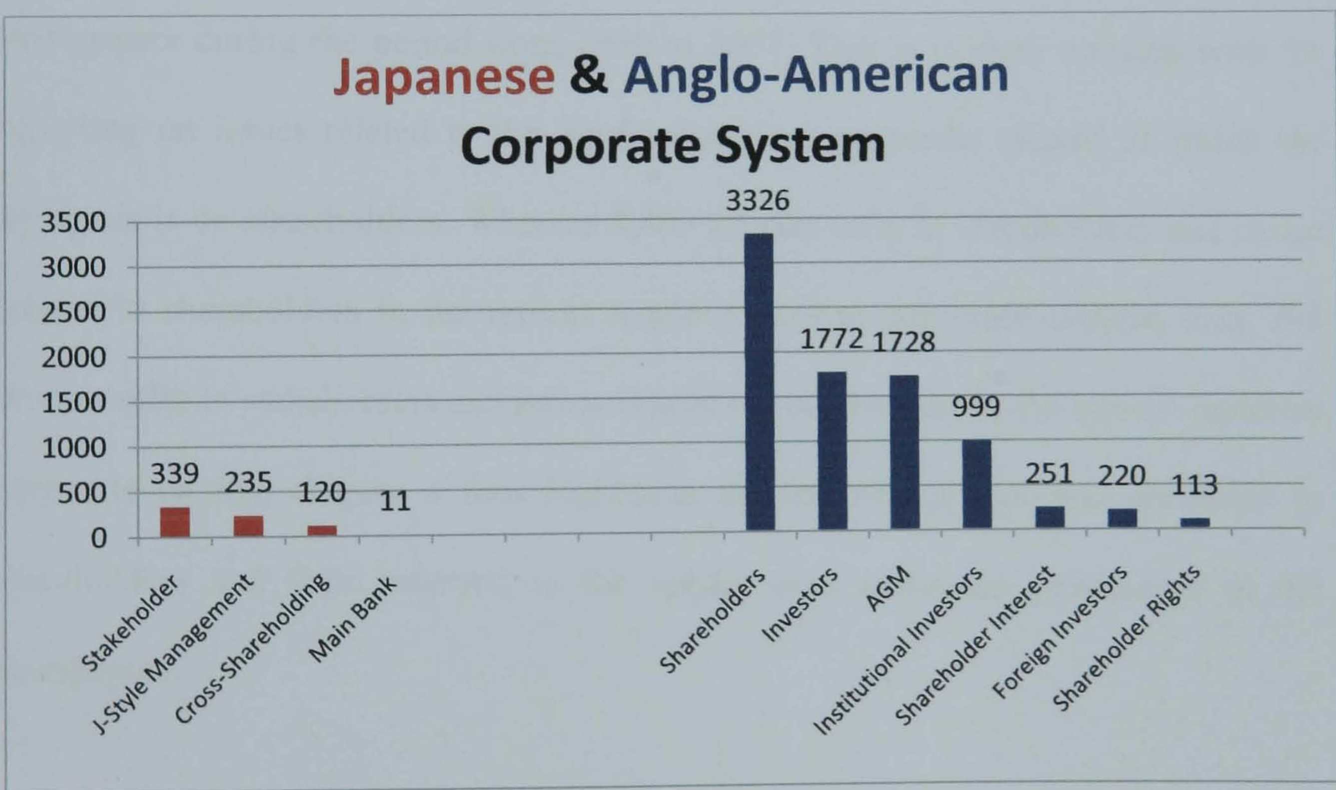

Figure 6: Components of the Japanese and the Anglo-American Corporate System

Any corporate governance system is embedded within a particular corporate system with which it interrelates, that is, which it reflects and impacts upon. The Japanese corporate system is in many ways different from the U.S. and U.K. corporate system (see above). It is of interest to explore the extent to which the newspapers in their reporting of corporate governance refer to the Japanese corporate system during the period surveyed here. Figure 6 provides insights into the extent of the reporting of key components of the Japanese corporate system and contrasts this to the reporting of components of the Anglo-American corporate system.

Japanese-style management, cross-shareholding and the main bank system, which sustain the Japanese corporate governance system and stakeholders, which are the key focus of the traditional Japanese firm, are rarely referred to in articles by the newspapers during the period from 1990 to 2007. This is in stark contrast with the reporting on issues related to the Anglo-American corporate system in which the emphasis is on shareholders. Whereas 8,409 articles refer to shareholders and issues related to shareholders in the typical Anglo-American corporate context, only 705 articles refer to stakeholders and issues related to stakeholders in the typical Japanese corporate context. Figure 6 thus highlights the importance that was attributed to shareholders and their interests in the debate over corporate governance in the newspapers.

The academic literature on corporate governance in Japan commonly refers to a challenge to the Japanese corporate governance system by the Anglo-American corporate governance system and a pressure to converge the Japanese corporate governance system with the Anglo-American corporate governance system. It is thus of interest to explore whether there is an emphasis on either the U.K or the U.S. in the corporate governance reporting of the sample newspapers. The comparison of the frequency with which newspaper articles referred to either the U.S. or the U.K. in their corporate governance reporting during the period from 1990 to 2007 highlights an emphasis on the U.S. (Figure 7).

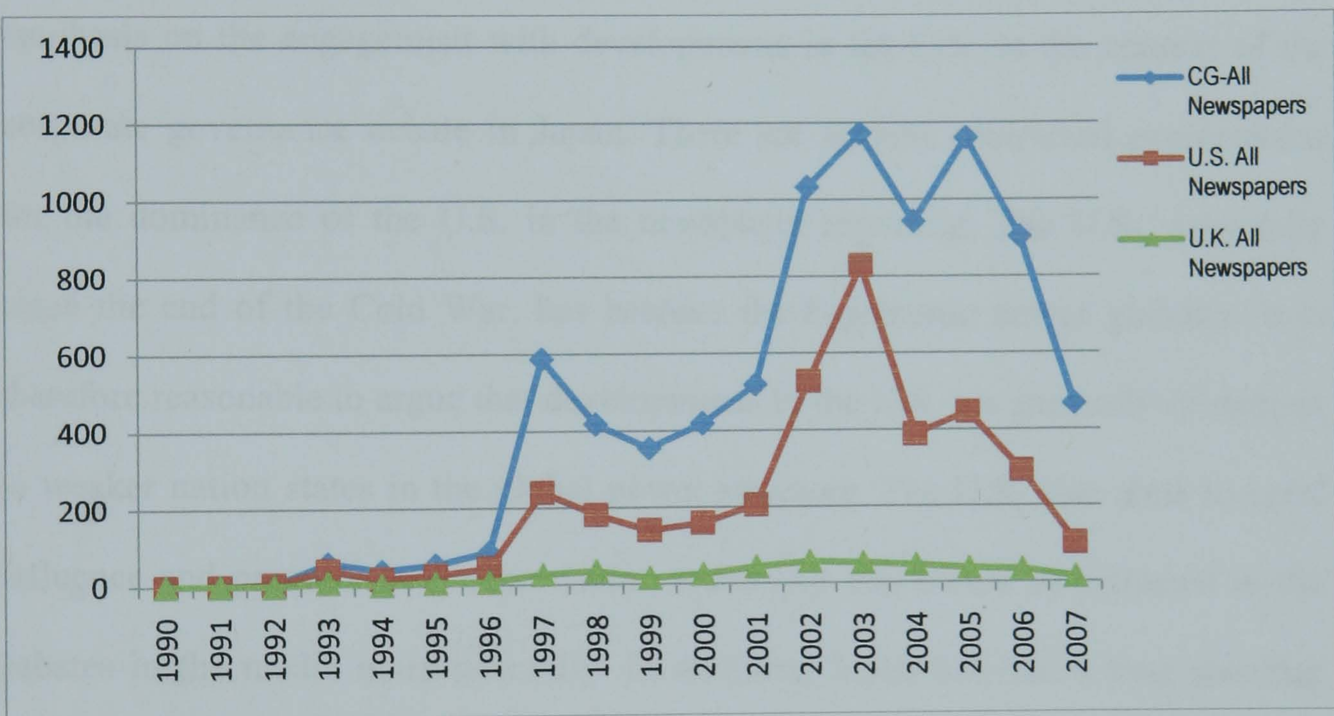

Figure 7: U.S. and U.K. Influence on the Corporate Governance Debate in all Newspapers

Out of a total number of 4059 articles making reference to both countries, 90 % of the articles referred to the U.S. whereas only 10 % referred to the U.K. Moreover, the trend in referring to the U.S. mirrors the trend in the corporate governance reporting evident in the newspapers during the period under focus. Interestingly, there are no clearly identifiable peaks in the number of articles that refer to the U.K. The lack of engaging with corporate governance developments in the U.K. is also reflected in the frequency with which newspaper articles refer to the Cadbury Committee, whose report constitutes a key document in the context of the development of the Anglo-American corporate governance system. Only 11 articles during the whole period refer to the Cadbury Committee.

The results of the content analysis of the newspapers thus indicate a strong emphasis on the engagement with developments in the U.S. in the context of the corporate governance debate in Japan. There are several contextual explanations for the dominance of the U.S. in the newspaper reporting. The U.S., especially since the end of the Cold War, has become the hegemonic power globally. It is therefore reasonable to argue that developments in the U.S. are generally of interest to weaker nation states in the global power structure. The U.S. also aims to exert influence and pressure over other nation states and this would be reflected in the debates in the media more generally. In addition, Japan has had a long standing relationship with the U.S. in terms of trade and national security that dates from the end of the Second World War. This particular relationship, however, has never been one on an equal basis with Japan being the weaker partner. In such a context, trade dependency and security dependency impact upon what a nation state can and cannot do. From that it follows that Japan needs to engage with demands made by the U.S. in terms of changes of the Japanese corporate governance system and developments in the U.S. corporate governance system.

6.4. SUMMARY

Chapter six has provided a brief comparison of the main characteristics of the Japanese and Anglo-American corporate governance system and the Japanese and Anglo-American corporate system. It highlighted how the systems reflect the values of the two different cultures. The chapter also offered an analysis of the key trends and key issues in the public debate as evident in Japanese general and financial newspapers. And, it provided an analysis of the key positions taken by Japanese constituencies who are affected by changes in the corporate governance system. Based on this analysis it provided a rationale for the choice of the *Japan Corporate Governance Forum's Principles of Corporate Governance* as the empirical material for the analysis in chapter 8. The next chapter, chapter 7, focuses on the bi-lateral trade negotiations between Japan and the U.S. during the period from 1989 to 2007.

CHAPTER 7

CORPORATE GOVERNANCE AND THE BILATERAL TRADE NEGOTIATIONS BETWEEN JAPAN AND THE U.S.

This chapter aims to gain insights into how corporate governance issues were embedded in the bilateral trade negotiations between the U.S. administration and the Japanese government during the period from 1989 to 2007. More specifically, what were the positions and roles of accounting disclosure and corporate governance practices in these negotiations? What tensions and issues arise in a context where one nation state puts pressure on another nation state, on the face of it, to change its corporate governance system in line with its own? And, more particularly, how far does the U.S. pressure on Japan to adopt an Anglo-American corporate governance system threaten cultural particularities of the Japanese context and way of life? Further, how might an individual nation state resist global power in relation to trade negotiations? And, how does an apparently weaker negotiating party act in the context of pressure to change its corporate governance practices and system so as to conform to what is perceived to be or portrayed as good corporate governance practice by the apparently stronger negotiating partner?

Trade negotiations are an important aspect of international relations and have a significant impact on the well-being of people in individual nation states. Yet there has been a paucity of research that focuses on corporate governance (including accounting) practices as areas or issues addressed in these negotiations. This chapter here aims to begin to fill the gap by offering contextual and interdisciplinary analysis of key documents in the context of the bilateral trade negotiations between the U.S. and Japan from the late 1980s onwards. The focus is on interpreting, consistent with a critical social analysis, how corporate governance issues are discussed in these documents.

The first section of the chapter outlines key characteristics of the relationship between the U.S. and Japan from 1945, the end of World War II, onwards. An appreciation of the relationship between the two negotiating partners facilitates analysis as it helps shed light on the suggestions made by the U.S. administration to the Japanese government in relation to its corporate governance system and Japan's response to it. It also facilitates insights into the broader issues at stake, of which debates over corporate governance were part. In the analysis of the trade negotiations, a chronological approach is adopted as this helps to identify continuities and discontinuities in terms of strategies proposed and issues addressed during the period under focus. It also gives better insights into whether changes in administration and government had an impact on the nature of debates over accounting disclosure and corporate governance.[88] The documents that have been chosen for the analysis reflect a concern to gain insights into how corporate governance issues were discussed, what interests ostensibly motivated the way

[88] As this case study is interested in changes proposed and made to the Japanese corporate governance system and the impact of that on the Japanese way of life, the focus is only on the proposals made by the U.S. administration to the Japanese government during the bilateral trade negotiations. An analysis of the suggestions that the Japanese government made to the U.S. government in the context of the bilateral trade negotiations is thus not the focus of the elaborations here.

these discussions developed, how the Japanese government dealt with the apparent pressure to change the Japanese corporate governance system and what real and potential threats did these suggestions and changes constitute to the Japanese way of life and beyond. The remainder of the chapter is structured as follows: a brief historical overview of the U.S.-Japanese relationship since World War II; analysis of the debate over corporate governance in relation to the research questions; summary of our insights from the analysis.

7.1. HISTORICAL OVERVIEW OF THE RELATIONSHIP BETWEEN THE U.S. AND JAPAN

There are two issues that appear to have played a significant role in shaping the relationship between the U.S. and Japan after World War II: security and trade. The emphasis on these issues shifted variously during the period from 1945 to 2008 reflecting changes in the broader global socio-economic and political context as well as specifically in the national context of the U.S. and U.K. (Vogel, 2002). After World War II, a close relationship developed between the U.S. and Japan in the context of the U.S. being the dominant force in the occupation army. The occupation authorities had a significant impact on Japan in terms of shaping the legal and administrative framework. Thus, the constitution of Japan, for example, reflected the U.S. notion of democracy as well as U.S. values. This close relationship between the U.S. and Japan also remained after Japan had gained independence on 8th September 1951 by concluding a treaty of peace, named the

San Francisco Peace Treaty, with forty eight countries. The relationship was motivated by a mutual interest of both partners. The U.S., concerned about security in the light of a recovering USSR, was keen to have military bases on Japanese territory. Japan in turn, having been isolated from its neighbours because of the position taken during World War II was keen to secure the help of the U.S. in the event of an invasion. Subsequently, Japan and the U.S. signed the *Treaty of Mutual Cooperation and Security*, which gave the U.S. a special position amongst the other treaty partners of the *San Francisco Peace Treaty*: Japan allowed the U.S. to set up military bases in Japan and in return got assurance that the U.S. would help defend Japan in the case of an invasion by (an)other country(ies) (Green, 2002; Vogel 2002, p.1). The U.S. helped integrate Japan into the Western bloc, which was acting as a force against communist countries. Having emerged as a member of a group of so-called democratic and capitalistic countries, Japan could now begin her recovery from the effects of World War II.

As part of its strategies to recover her economy, which had been severely damaged during World War II, Japan began to seek overseas markets, especially in the U.S. Vogel (2002, p. 1) points out that 'the United States also supported Japan's economic recovery by allowing Japan to limit the reparations paid to war victims, by creating a liberal international trade regime, and by maintaining open markets at home while tolerating Japanese trade protection and an undervalued yen'. With this support from the U.S., which was in the interest of the U.S. because of the concern about security. Japan made a remarkable economic recovery after World War II.

Grimes (2002, p. 35) points out that Japan's economic recovery had a significant impact on the nature of the relationship with the U.S.:

> The U.S.-Japan relationship in the postwar era has been distinctly asymmetrical, particularly in macroeconomic terms, with Japan far more dependent on the United States than the other way around. Japan's extraordinary rise as a world economic and technological power changed the degree of asymmetry substantially, however, and created major friction in the bilateral relationship.

The economic and industrial conflict between the U.S. and Japan already arose in the 1960s, evident in steel and agricultural conflicts. From the 1960s onwards, the U.S. government has aimed to improve access to the Japanese market especially for its corporations and investors. Lincoln (1999, p. 117) explains that during the 1960s and 1970s, U.S. government officials had been able to negotiate agreement with the Japanese government 'on substantially eliminating quotas and lowering tariffs' (*ibid.*) These negotiations had taken place on two levels: the multilateral level of the *General Agreement on Tariffs and Trade (GATT)* and the bilateral level between the two nation states (*ibid.*). The tensions between the two countries intensified in the 1980s, as Lincoln explains:

> ...during the 1980s, the Reagan administration pursued a collection of tariff, quota, and other non-tariff issues with the Japanese government. Limited success on some of these problems and the highly public opposition of the Japanese government led to rising tension as the decade wore on. Trying to accelerate progress, the Reagan administration created the Market-Oriented Sector Selective (MOSS) negotiations in 1985, a process that involved intense negotiations on a number of impediments in four industries (forest products, medical equipment and pharmaceuticals, electronic products, and telecommunications equipment and services). (Lincoln, 1999, p. 117).

The shift away in the relationship between the U.S. and Japan from the primary focus of security as evident in the aftermath of World War II to a focus on economic issues from the 1960s is congruent with Japan's economic success. Further, the 1980s saw extraordinary growth of the Japanese economy whilst the U.S. experienced an economic down-turn during the same decade. Towards the end of the 1980s, the U.S. trade deficit had culminated to around fifty billion dollars a year (Iha, 1991). In the context of the economic situation in the U.S., the Reagan administration came under criticism, especially from U.S. business interests, as it was perceived that they had not satisfactorily dealt with the issue of Japan. One suggestion thus was that the U.S. government should modify its attitude towards Japan and become more aggressive (Aoyagi, 1991, p. 91; Iha, 1991, p. 107). There was also pressure from industry on the government to deal with this issue (Schoppa, 2002). In the context of this rising dissatisfaction, Congress, in which Democrats held the majority, passed the *Trade Act of 1988*. This Act significantly impacted on the U.S.-Japan relationship as it stipulated that the Reagan administration had to identify countries that were 'unfair traders' and aim to overcome any problems through negotiations.[89] With this law, the Reagan administration lost control over the issues it wanted to address with Japan as well as its negotiating strategies (*ibid.*). Lincoln comments:

> Although Congress acted out of a partisan dissatisfaction with the Reagan administration's trade policies, many within the administration were also increasingly frustrated in their dealings with Japan. In this atmosphere of heightened awareness of continuing access problems in Japan, increasing frustration at the slow pace of progress in making markets more open, and

[89] This provision in the law is known as Super 301 (*ibid.*)

> rising discontent in Congress, the Bush administration took office in 1989. (Lincoln, 1991, pp. 117-118)

Changes in the global political context further gave impetus to those in the U.S. administration who were calling for a change in the U.S.–Japan relationship. Of significance was the end of the Cold War, which reduced the perceived threat to U.S. security thus impacting upon its relationship with Japan. As Green explains:

> In the first half of the 1990s the alliance suffered both from neglect and from crisis. The end of the cold war competition empowered those in the U.S. government who had wanted to focus on trade relations with Japan but had been constrained by strategic considerations. (Green, 2002, p.25)

The incoming Bush administration through pressure and the provision of Super 301 labelled Japan as an unfair trader and identified three product areas for negotiation: government procurement of satellites, government procurement of super computers and technical barriers in forest products (Lincoln, 1991, p. 118). This act resulted in a complex set of trade negotiations between the U.S. administration and the Japanese government.

In the following, a contextual and interpretive analysis of documents issued in the context of these initiatives during the period from 1989 to 2007 is offered. The focus of the analysis, as has already been explained (*supra*), is on how corporate governance featured in these debates in the situation whereby the U.S. government put pressure on the Japanese government to change the Japanese corporate governance system so as to reflect the Anglo-American corporate governance system.

7.2. THE BI-LATERAL TRADE NEGOTIATIONS (1989-2007)

The bi-lateral trade negotiations started in 1989 after Japan had been labelled as an unfair trader by the incoming Bush administration. The negotiations were carried out by the U.S. government and the Japanese government in the context of various frameworks and initiatives that were set up to either provide a coherent overarching structure for the negotiations or to focus on particular aspects within this broader structure. The objectives of these negotiations were to minimise the U.S. trade deficit with Japan and to open up the Japanese market for international, especially U.S., investors. In this context liberal reforms and marketisation were seen as vital for the successful opening of the Japanese market. Within these general objectives a key concern was with aspects of the Japanese institutional framework, which were perceived by the U.S. as constituting structural impediments in the context of trade between the two countries. One particular concern was the Japanese corporate governance system (including its accounting system). The trade negotiations were shaped by the different U.S. and Japanese governments and presidents/prime ministers in office during the period from 1989 to 2007. Table 9 offers a summary of the initiatives and frameworks, which addressed corporate governance issues and that constitute the empirics for the analysis here.

The *Structural Impediments Initiative* was launched in 1989. This initiative is the first of a number of initiatives in the 1990s and the first decade of the twenty first

YEAR	PRESIDENTS/ PRIME MINISTERS	INITIATIVE
1989 - 1992	President George W. Bush Prime Minister Uno	U.S.-Japan Structural Impediments Initiative
1993 - 1995	President Bill Clinton Prime Minister Hashimoto	U.S.-Japan Framework for a New Economic Partnership (*Framework*)
1997 - 2001	President Bill Clinton Prime Minister Hashimoto	U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (Enhanced Initiative)
2001 - 2007	President George W. Bush Jnr Prime Minister Koizumi	U.S.-Japan Economic Partnership for Growth (Partnership) • *The Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative)*

Table 9: Bi-lateral Trade Negotiations (1989-2007)

century in the context of the bilateral trade negotiations between the U.S and Japan. Subsequent U.S. administrations also entered into bilateral trade negotiations with Japan. After the Clinton administration had come to power, it negotiated the *U.S.-Framework for a New Economic Partnership* in 1993 and launched another initiative with the Japanese government, the *U.S.- Japan Enhanced Initiative on Deregulation and Competition Policy (Enhancement Initiative),* in 1997. The incoming Bush (Junior) administration launched a new partnership agreement with Japan in 2001, the *U.S.-Japan Economic Partnership for Growth (Partnership)*, and replaced the *Enhancement Initiative* with the *Regulatory Reform and Competition Policy Initiative* (*Regulatory Reform Initiative*). In the context of the various frameworks and initiatives, documents were issued that amongst other

YEAR	DOCUMENT
U.S.-Japan Structural Impediments Initiative	
1990	• Structural Impediments Initiative Interim Report • Structural Impediments Initiative Joint Report
1991	• First Annual Structural Impediments Initiative Report
1992	• Second Annual Structural Impediments Initiative Report
U.S.-Japan Framework for a New Economic Partnership (Framework)	
1994	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation and Administrative Reform in Japan
1995	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Administrative Reform and Competition Policy in Japan
1996	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Administrative Reform and Competition Policy in Japan
U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (Enhanced Initiative)	
1997	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Competition Policy, and Transparency and other Government Practices in Japan
1998	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Competition Policy, and Transparency and other Government Practices in Japan • First Joint Status Report on the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy
1999	• Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Competition Policy, and Transparency and other Government Practices in Japan • Second Joint Status Report on the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy
2000	• Annual Submission by the Government of the United States to the Government of Japan Under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy • Third Joint Status Report on the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy
U.S.-Japan Economic Partnership for Growth: *The Regulatory Reform and Competition Policy Initiative*	
2001	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Fourth Joint Status Report on the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy
2002	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • First Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative
2003	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Second Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative
2004	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Third Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative
2005	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Fourth Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative
2006	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Fifth Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative
2007	• Annual Reform Recommendations from the Government of the United States to the Government of Japan Under the U.S.-Japan Regulatory Reform and Competition Policy Initiative • Report to the Leaders on the U.S.- Japan Regulatory Reform and Competition Policy Initiative

Table 10: Documents Issued During the Bi-Lateral Trade Negotiations (1989-2007)

issues addressed corporate governance more generally and specific components of the corporate governance system. In addition, aspects of the Japanese corporate system were also addressed in these documents. Table 10 lists the documents, which are the focus of analysis of this chapter. In the following, an analysis of these documents is offered. The analysis is in chronological order so as to show developments and changes in the debate.

7.2.1. The Structural Impediments Initiative (1989 – 1992)

In July 1989, the Heads of State of the U.S. and Japan, President Bush Senior and Prime Minister Uno, agreed to launch the *Structural Impediments Initiative (SII)* in an attempt to overcome trade and economic issues and to thus strengthen the relationship between the two nations (Naka, N., 1996). In a press release, the White House claimed that "the SII talks represent... [an]...approach that may be unique in the history of bilateral trade and economic discussions. The talks were designed to identify and resolve the structural impediments that contribute to economic tensions between the two countries" (U.S.-Japan Working Group on the Structural Impediments Initiative, 1990a, p.1). [90] The main concern was to reduce the reduction of payments imbalances between the two countries (U.S.-Japan Working Group on the Structural Impediments Initiative, 1990b, p. 2). A U.S.-Japan Working Group was set up to investigate the issues and held plenary meetings in

[90] The Working Group issued an *Interim Report* (U.S.-Japan Working Group on the Structural Impediments Initiative, 1990a), which in the following is referred to as "*Interim Report* on SII".

September and November 1989 to identify specific structural impediments. In February 1990, the working group met again to explore policy changes that might facilitate a speedy resolution of the identified problems. The U.S. government identified the following structural impediments, which the Japanese government was requested to address: Japanese Savings and Investment Patterns, Land Use, Distribution System, Exclusionary Business Practices, *Keiretsu* Relationships and Pricing Mechanisms (*ibid*, p. 2). In an interim report released by the U.S.-Japan SII Working Group on 5 April 1990, the Japanese and U.S. delegations reported on the progress made so far by their respective governments in attending to the structural impediments identified. Below, the response of the Japanese delegation is analysed in relation to corporate governance issues.

7.2.1.1. Structural Impediments (SII) Interim Report (1990)

Of particular interest in relation to corporate governance is the response of the Japanese delegation to the structural impediment that the U.S. administration had identified as *Keiretsu Relationships*. *Keiretsu* have been especially seen by the U.S. government and by U.S. investors as contributing to the closure of Japanese markets to foreign investors. The Japanese delegation refers to this perception in its report:

> Certain aspects of economic rationality of Keiretsu relationships notwithstanding there is a view that certain aspects of Keiretsu relationships also promote preferential group trade, negatively affect foreign investment in Japan, and may give rise to anticompetitive business practices (Interim Report on SII, p. 15).

The Japanese government suggested that it would address this issue in the following way:

> ...the Government of Japan intends to make Keiretsu more open and transparent. The Government will take measures in its competition policy and enforce the Antimonopoly Act strictly, so that business transactions among companies with the background Keiretsu relationship would not hinder fair competition. The government of Japan will also promote a wide range of policies to facilitate the entry of foreign enterprises into the Japanese market (Interim Report on SII, p. 15).

The concern with *keiretsu* was part of a broader concern that the U.S. government had also addressed in another structural impediment, which it had referred to more generally as *Exclusionary Business Practices*. In responding to both structural impediments, the Japanese government was concerned to highlight its willingness to address the issue of closed markets for foreign businesses and investors. In terms, for example, of the procurement practices of private Japanese companies '[t]he government of Japan believes that...procurement by private firms should be non-discriminatory against foreign goods' (Interim Report on SII, p. 15). The reference to openness and transparency indicates a link to corporate accounting disclosure, which is an important component of corporate governance systems.[91] One of the measures to be taken in order to facilitate more transparent operations of *keiretsu* is

[91] It is of note that even if the term "corporate governance" was not used by the Japanese government, the reference to accounting disclosure implicitly was also a reference to the corporate governance system, of which disclosure and transparency are key components. Instances such as this can be found in history. For example, Jeremy Bentham was interested in accounting disclose and made it an integral part of his writings on management although he never used the word "accounting" as in his context, i.e. before the establishment of the accountancy profession, the word "publicity" was used to signify that practice that later became known as "accounting disclosure" (Gallhofer and Haslam, 2003). And, Bentham had a lot to say about "social accounting" without ever mentioning the term "social accounting" (*ibid.*).

thus to enhance disclosure requirements.[92] Various measurements are here addressed. For example, the Japanese government was considering the introduction of 'the so-called 5 percent rule, which requires the disclosure of substantial ownership in shares'. In addition to this, further measures are proposed:

> With respect to the disclosure requirements related to the Keiretsu problem, the government of Japan will examine areas in which improvements are needed for their further enhancement, taking into account the disclosure requirements in the U.S. and Europe, and will reach a conclusion before the final SII report is submitted. It is envisaged that improvements in disclosure requirements will include enhanced reporting of related-party transactions as well as consolidated financial information (Interim Report on SII, p. 17).

Of interest here is the reference to accounting disclosure requirements not only of the U.S. but also of Europe, which indicates Japan's affinity with Europe and especially with Germany since the late nineteenth century (*supra*). The Japanese government also proposes a 'Reexamination of Company Law' in order to improve disclosure requirements and to streamline mergers and acquisition procedures (*ibid.*). The emphasis of the Japanese government on disclosure and the willingness to improve accounting disclosure seems to reflect the perception of accounting in the Japanese context. Japan has been a founding member of the *International Accounting Standards Committee (IASC)* and the *Japanese Institute of Certified Public Accountants (JICPA)* has been involved in attempts to converge Japanese accounting standards with *International Accounting Standards (IASs)* and *International Financial Reporting Standards (IFRSs).* Further, there was a

[92] Other measures include the strengthening of the function of the Fair Trade Commission, increasing the openness to Foreign Direct Investment, and revision of the takeover bid system.

perception at the time of the bi-lateral trade negotiations that converging accounting standards and enhancing disclosure was beneficial for business and thus desirable. *Nippon Keidanren (Japan Business Federation)* (2003) explain that '[i]n the past few years, Japan has been energetically reviewing its accounting and auditing standards with an eye to harmonizing them with those in the West wherever possible' and stress that they have 'consistently supported the convergence of accounting standards' (Nippon Keidanren, 2006). Of interest here is the position taken by *Nippon Keidanren*, which highlights the importance of disclosure for Japanese businesses in the wider global context:

> With today's rapid advancement of globalization, the flow of people, goods, and funds is becoming ever more robust. Due to the instant traverse of funds in capital markets, companies and investors can now select the market with the best conditions and raise and invest funds at places they wish. Accordingly international comparability of accounting standards is becoming of increased importance as part of business infrastructure (Nippon Keidanren, 2006).

Nippon Keidanren therefore suggest:

> Japan should vitalize the nation's capital market and strengthen corporate dynamism while nurturing and developing globally-competitive and high-quality industry that creates products and services with high added value. The key tasks Japan has to tackle now, is to accelerate convergence and to realize the mutual recognition of standards among Japan, the United States, and Europe by 2009 (Nippon Keidanren, 2006).

The suggestions made by the Japanese governments in relation to transparency and disclosure were congruent with the position taken by Japanese business as indicated above.

In its response to the report of the Japanese delegation, the U.S. delegation is positive about the 'substantial progress at this stage of the Structural Impediments Initiative (SII) talks' and holds that '[m]any of the measures in the interim report should contribute to the goals of opening markets, reducing trade and current account imbalances, and promoting consumer interests' (Interim Report on SII, p. 19). At the same time, however, the U.S. delegation points to the need for further progress in these areas:

> Additional progress is needed in subsequent SII talks to develop the plans and actions more fully in some areas. The effectiveness of the measures and commitments will depend upon achieving greater specificity in the commitments, and, ultimately, on the actual implementation of measures to reduce or eliminate the structural impediments (*ibid.*)

In terms of the *keiretsu relationships,* the U.S. delegation positively highlighted the Japanese government's suggestion to increase disclosure requirements and enhance the transparency of the *keiretsu.* At the same time, the U.S. delegation was, however, of the opinion that further measures needed to be taken:

> The U.S. government believes that it is essential for the government of Japan to build on the commitments enumerated above through additional actions and commitments in a number of areas, including: issuance of a broader policy statement encouraging the loosening of keiretsu ties; further actions to address the cross shareholding issue; measures to encourage opening of keiretsu procurement practices; further steps to relax or abolish the broad authority of the Government of Japan to restrict foreign direct investment and the importation of technology on broad-economic grounds; and measures to bolster shareholders rights in Japan (Interim Report on SII, p. 24).

Of particular interest in terms of corporate governance is the specific reference to 'shareholder rights' in the statement of the U.S. delegation, which was not included in the report of the Japanese delegation. The U.S. delegation's reference to shareholder rights points to the objective of the firm that underpins the Anglo-American corporate governance system, namely maximising shareholder wealth. In the Japanese corporate governance system the focus is not on shareholder interest but employee interest and rights, which is reflected in practice in the objective of maintaining long-term growth. Of relevance for the argumentation here is that the different focuses evident in the Japanese and Anglo-American corporate governance systems (i.e. shareholder interest and employee interest) are linked to different employment and management practices (see, for example, Dore, 1998). Of significance here in the Japanese context are employment practices such as, for example, life-long employment and seniority based pay and promotion. In light of the above differences between the Japanese and U.S. corporate system and corporate governance system the potential significance of a shift away from employee interest and rights to shareholder interest and rights becomes evident. The request made by the U.S. government that the Japanese government should bolster 'shareholders rights in Japan' (Interim Report on SII, p. 24) thus constituted a potential threat to Japanese business practices and the Japanese community firm. Moreover, such a change in business practices could also have a significant impact on peoples' well-being, for example, if life-long employment was to be replaced by more short-term employment practices (*subter*). Iha (1991) explains that the suggestions made by the U.S. were a threat to the Japanese way of life because of the change in economic policy they implied. She points out that Japan's emphasis traditionally has been to put industry first and then customers. The argumentation of the U.S., however, reversed this emphasis: customers had to be considered first and industry second. Such a change in focus, according to Iha (1991), potentially jeopardises policies that would protect employees.

It is of note that in the *Interim Report* on SII the term corporate governance is not specifically mentioned although issues related to corporate governance are more evidently addressed. [93] These include shareholder rights, transparency and accounting disclosures and mergers and acquisition rules. These issues feature prominently in debates on the Japanese corporate governance system in the 1990s and the beginning of the twenty first century. In addition to corporate governance issues the *Interim Report* on SII also identifies characteristics of the Japanese business system, such as *keiretsu* and cross-shareholdings, as areas that needed change. In subsequent debates, these characteristics of the Japanese business system became even more of a focus of the U.S. critique of the Japanese corporate governance system.

[93] At first glance it might be surprising that there is no specific reference to the term "corporate governance" in the *Interim Report* on SII, given that the Japanese corporate governance system subsequently became such an important issue of debate between the two nation states. A possible reason for this might be that, at the time of the talks, corporate governance had not yet reached the level of importance in public policy debate that it was to reach especially after the publication of the *Cadbury Report* in 1992 and in the light of spectacular corporate frauds in the U.S. and U.K. (Mallin, 2006b).

7.2.1.2. Japan Structural Impediments Initiative Joint Report (1990)[94]

The U.S.-Japan Working Group on the Structural Impediments Initiative (SII) issued its *Joint Report on SII* on 28 June 1990 (U.S.-Japan Working Group on the Structural Impediments Initiative, 1990b). The Working Group points to the significance of the *Structural Impediments Initiative* at the beginning of its Joint Report:

> The Working Group believes that this report is a historic document that contains significant, extensive efforts and actions on both sides. These actions should complement the economic policy coordination efforts which have been made through multilateral fora and should contribute to a reduction in external payments imbalances. In this regard, it is to be noted that while the large external imbalances of the two countries have shown substantial reduction in recent years, the two Governments are strongly committed to make efforts for the further reduction of their respective external imbalances. The above mentioned actions [i.e. those related to the structural impediments] should also lead to more efficient, open and competitive markets, promote sustained economic growth and enhance the quality of life in both Japan and the United States. Both Governments are firmly committed to achieve these goals (Joint Report on SII, p. 2).

The *Joint Report on SII* again contained the reports by the Japanese and the U.S. delegation. This time, however, neither delegation commented on the other party's report. These comments had ostensibly already been taken into account in finalising the Joint Report.

The report of the Japanese delegation in the *Joint Report on SII* evidenced an important difference compared to its report in the *Interim Report on SII*: whereas

[94] This report (U.S.-Japan Working Group on the Structural Impediments Initiative, 1990b) is in the following referred to as *Joint Report on SII*.

the *Interim Report* listed measures that were to be taken by the Japanese Government to resolve the structural impediments, the Joint Report already reported on specific measures that had already been taken since the publication of the *Interim Report* in April 1990. For example, the *Interim Report* mentioned that the Japanese Government intended to strengthen the function of the *Fair Trade Commission (FTC)* (Interim Report on SII, p. 15). In the Joint Report, just two months later, the Japanese Delegation already referred to the recommendations of the *Advisory Group on Distribution Systems, Business Practices and Competition Policy*, which had been established by the FTC to look into 'the continuity and exclusiveness of the transactions among companies in the same *keiretsu* group whether or not cross shareholding is involved' (Joint Report on SII, p. 14). The Japanese delegation also referred to measures already taken and still to be taken to facilitate and foster foreign direct investment in Japan with the objective of reducing preferential group trade, which had been highlighted as a negative characteristic of *keiretsu* relationships by the U.S. administration and U.S. business interests and investors. The Japanese delegation reported:

> Furthermore, advisory offices for the promotion of foreign direct investment in Japan are to be set up in the overseas representative offices of the *Japan Development Bank* (JDB) in order to support foreign companies investing in Japan in co-operation with Embassies, Consulates-general and the *Japan External Trade Organisation* (JETRO) offices (Joint Report on SII, pp. 15-165).

The Japanese Government had also acted speedily and taken into account criticisms of its Take-Over Bid System. Whereas in the *Interim Report* the Japanese delegation referred to the Japanese Government's plan 'to submit a bill to this Diet session' (Interim Report on SII, p. 16), in the Joint Report it could already report that the Japanese Government had submitted to the Diet a Bill, which had been approved on 15 June 1990 (Joint Report on SII, p. 16). The *Interim Report* referred to the Japanese Government's intention to enhance the disclosure requirements and to reach a conclusion on the introduction of the 5 percent rule before the final SII report is submitted (Interim Report on SII, p. 17), whereas the Joint Report on SII already stated that the Bill had been passed and that 'the new rule would also require continuing reporting as investors above the five percent threshold acquire and dispose of blocks of shares in an amount equal to one percent or more' (*ibid,* p. 16). In addition to this change, the Japanese Government reported that it also had arrived at further measures to be taken to enhance the disclosure requirements of *keiretsu*. These measures were to cover, for example, related-party transactions, consolidated statements and segmental reporting (*ibid.*).

An additional major and significant difference in relation to the *Interim Report* was that the Joint Report now contained a reference to shareholders' rights, which the U.S delegation in its comments on the *Interim Report* had highlighted as being missing from the report of the Japanese delegation. We thus can find in the Joint Report the following statement by the Japanese government:

> The Committee on Legislation will examine the Company Law with a view to enhancing disclosure requirements and shareholders' rights, and to simplifying mergers and acquisition processes (p. 16).

The reference to shareholders constituted a challenge to the traditional Japanese view whereby shareholders' rights were perceived as less important than the rights of employees. As has been explained above, although the *Commercial Code* emphasised the shareholders as owners of the company, in practice the perception of management and society more generally was that employees were the key constituents of the corporate organisation (Inagami and Whittaker, 2005). Company objectives were focused on achieving long-term and sustainable growth rather than immediately on short-term profit maximisation. The inclusion of shareholders' rights into the statement of the Japanese government was of significance for the broader debate as it could have been interpreted as a submission of the Japanese government to the view that Japanese practices should be changed through implementing U.S. practices.

7.2.1.3. First Annual Structural Impediments Initiative (SII) Report (1991)[95]

In order to monitor the progress of the SII the Working Group agreed a follow-up process. The group was to meet 'three times in the first year and twice a year thereafter' to review progress on the issues identified in its *Final Report on SII* and, if necessary, discuss new plans for action in problem areas. In addition, the Working Group was to publish an Annual Report on SII in the spring of each year. It was planned to review this follow-up process three years after the release of the *Final Report on SII* (Final Report on SII, p.2). In May 1991, the *First Annual*

[95] This report (U.S.-Japan Working Group on the Structural Impediments Initiative, 1991) is referred in the following as *First Annual Report on SII.*

Structural Impediments Initiative (SII) Report was issued. In its joint Press Release, the Working Group was positive about the progress made by both governments and its impact on the economy and people more generally:

> We believe that the attached report contains progress to date regarding the implementation of the measures of both governments listed in the Joint Report that should contribute to the reduction of payments imbalances. These measures should also lead to more efficient, competitive, and open markets, promote sustained economic growth and enhance the quality of life in both Japan and the United States (First Annual Report on SII, p. 1)

In relation to the structural impediments associated with *keiretsu* relationships, the Japanese delegation highlighted the progress made in facilitating Foreign Direct Investment. A Bill to amend provisions of the *Foreign Exchange and Foreign Trade Control Law* with a view to minimise restrictions and to 'ensure fair and equitable access' to the Japanese market was submitted to the Diet on 26 February 1991 and enacted on 19 April 1991 (First Annual Report on SII).

In terms of the enhancement of disclosure requirements - referred to in the *Final Report on SII* – the Japanese delegation could report significant progress. A Bill to amend *the Securities and Exchange Law* so as to introduce the 5 percent rule was approved by Diet in June 1990 with the new requirement becoming effective on 1 December 1990 (*ibid.*). In addition, several other steps had been taken by the Japanese government since the publication of the Joint Report on SII:

> Among the measures to enhance the disclosure requirements related to the Keiretsu problem, in relation to enhancement of reporting of related-party transactions, disclosure of the consolidated financial statement in the primary annual statement and inclusion of sales amounts by major customers in unconsolidated financial report, the Government of Japan

promulgated a ministerial ordinance on December 25, 1990 that incorporated the whole contents that were stated in the SII *Final Report*. These measures have been implemented from the business year beginning on or after April 1, 1991. The rule of segmented financial reporting that incorporates the whole contents that were stated in the SII *Final Report* has also been implemented from the business year beginning on or after April 1, 1990 (First Annual Report on SII).

The Japanese Government did not intend to stop here although all the issues identified in the *Final Report on SII* had already been addressed and solved:

> Recognizing the character and structure of segmental reporting requirements in other industrial countries the GOJ thinks it important to make further enhancements of these requirements consistent with international efforts in harmonization of disclosure requirements (First Annual Report on SII).

The above two citations indicate a great willingness of the Japanese Government to put measures into place to enhance the disclosure practice of *keiretsu*. Interestingly, such an eagerness to comply with the requirements of the U.S. administration is not evident in all areas of the structural impediments identified by the U.S.

The Japanese government also appeared to have taken into account the request by the U.S. administration to focus on shareholders' rights. To this effect, the Legislative Council began to examine the Company Law with a view to enhancing 'disclosure requirements and shareholders' rights' (First Annual Report on SII). In addition, the issue of simplifying merger and acquisition procedures was also discussed by the Legislative Council. In terms of the enhancement of shareholders' rights, the Japanese delegation could report:

> The Legislative Council is also examining the enhancement of the disclosure requirements in the Company law [spelling in original], as well as the enhancement of the shareholders' rights. This includes facilitating the system of derivative lawsuits and improving shareholder access to corporate financial books and records (First Annual Report on SII).

The Japanese delegation also pointed to the sense of urgency that the Japanese government appeared to have in terms of arriving at a speedy solution for these issues of concern:

> The Japanese Government will make its best efforts to accelerate the deliberation process of the Legislative Council so that the conclusions may be reached as soon as possible. Immediately after receiving the Legislative Council's recommendations, legislation will be introduced in the Diet. The GOJ will explain on the progress of the Legislative Council's review in the 1992 follow-up meeting of the SII (First Annual Report on SII).

The comments of the U.S. delegation on the report of the Japanese delegation are of interest. The response begins by pointing to the benefits for Japan from implementing the commitments as summarised in the *Joint Report on SII*:

> These measures, if fully implemented and extended, should result in a more open, fair and transparent Japanese economic system. They should also benefit Japanese consumers, shareholders, importers, potential homeowners and small producers (First Annual Report on SII).

After acknowledging 'progress in a number of areas', the U.S. delegation argues that 'additional progress in all areas is necessary in order to contribute further to the goals of opening markets, reducing trade and current accounts balances, and improving the quality of life in Japan' (*ibid.*). The U.S. delegation argued:

> Among areas where progress has been disappointing are exclusionary business practices and – keiretsu. In particular, the Government of Japan

> should take additional steps to reinforce the antimonopoly enforcement regime so that it will effectively deter anticompetitive practices. In addition, substantial additional actions are needed to make keiretsu relationships more open and transparent, by, for example, addressing anticompetitive aspects of cross-shareholding, strengthening shareholders' rights, and encouraging stricter exchange listening requirements (First Annual Report on SII).

It will be of interest to see if and how the Japanese government reacted to these criticisms and further demands by the U.S. delegation.

Analysis of the *First Annual Report* on SII indicates that the Japanese government had made attempts to enhance disclosure and that it also had embraced shareholders rights. In contrast, the Japanese government had suggested little changes in relation to *keiretsu* and cross-shareholding. This is not so surprising if one considers that cross-shareholding is a key component of the Japanese corporate system. A change in cross-shareholding would mean a change of the corporate system, which in turn would affect the Japanese corporate governance system.

7.2.1.4. Second Annual Structural Impediments Initiative (SII) Report (1992)[96]

The *Second Annual Report on SII* is of interest as it further expands on disclosure requirements for *keiretsu*. This seems to be a response to the criticism voiced by the U.S. delegation about the rate of progress of the Japanese government in terms of implementing the commitments, which were outlined in the *Final Report* on SII.

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96 This report (U.S.-Japan Working Group on the Structural Impediments Initiative, 1992) is referred to in the following as *Second Annual Report on SII*.

In the *First Annual Report* on SII the Japanese delegation had indicated that the Japanese government was concerned to further enhance segmental reporting. Now the Japanese delegation was able to be more specific in terms of the implications of the government's intention:

> The GOJ considers it important to further improve the scope of segmented disclosure requirements and recognizes that standards of disclosure in other major industrial countries include information by overseas subsidiaries by geographic regions (Second Annual Report on SII).

In order to enhance 'the disclosure requirements and the shareholders' rights in the Commercial Law' the Legislative Council had continued discussing issues addressed in the last annual report, such as 'improving shareholders' access to corporate financial books and records by relaxing share requirements needed for access to a meaningful extent, and facilitating derivative lawsuits' (*ibid.*). The Legislative Council also continued 'its re-examination of restrictions on the companies' repurchase and holding of their own shares' (*ibid*).

The *Second Annual Report* also makes reference to shareholder meetings, the character of which had been heavily criticised by Western commentators. They had held that these meetings were staged and did not allow shareholders to adequately address their concerns. In addition, all Annual General Meetings (AGM) were traditionally taking place at the same time, which made it impossible for shareholders to attend more than one AGM. In the Japanese context of cross-shareholding and the main bank system, AGMs traditionally were not the main source of shareholder control. In the light of such criticism, the Japanese delegation was concerned to give reassurance:

> The Government of Japan expects that the Japanese Companies will operate shareholders' meetings properly according to the provisions of the Commercial Law. The GOJ confirms that the Commercial Law enables shareholders to exercise their voting rights through their proxies and to exercise them disunitedly, and it also expects that the parties concerned will give their careful considerations to avoid possible obstacles to the exercise of shareholders' voting rights by foreign shareholders (Second Annual Report on SII).[97]

In summary, similar to the *First Annual Report* the *Second Annual Report* put an emphasis on Japanese actions in relation to disclosure and to shareholder rights, especially voting rights.

It is of interest that according to the initial agreement of the *Japan-U.S. Working Group on the Structural Impediments Initiative (SII)* in 1989 it had been envisaged that there would be another year of biannual meetings and the publication of a *Third Annual Report* in spring 1993, which would report on the progress made by the U.S. and Japanese governments in solving the structural problems, which had been identified in the *Final Report on SII.* A Third Report, however, never materialised as the Bush administration was superseded by the Clinton administration in 1993. Consequently the *Structural Impediments Initiative* was terminated.

[97] The copy of the *Second Annual Report* on SII that is available does not include any comments of the U.S. delegation on the progress made by the Japanese government.

In summary, although the term "corporate governance" was not mentioned in the SII documents, characteristics of the Japanese business context and the Japanese corporate governance system were addressed in the documents issued during the initiative. As had been argued above, the concern with *keiretsu,* and relatedly cross-shareholding, is a concern with aspects of the Japanese business context. References to disclosure requirements, merger and acquisition rules, the nature of shareholder meetings and voting rights, which were issues addressed in the negotiations are all important characteristics of the Anglo-American corporate governance system. These issues were deemed important by the U.S. administration in the context of its objectives to open up the Japanese market to U.S. investors and firms, to reduce the payments imbalances between the two nation states and to promote 'more efficient, open and competitive markets in Japan and the United States' (First Annual Report on SII). Changes implemented by the Japanese government regarding these areas were part of broader liberalisation attempts in Japan starting in the early 1980s (see, for example, Hall, 1998; Hoshi and Kashyap, 2001; Cargill and Sakamoto, 2008). They also reflect concerns especially expressed by Japanese business (Nippon Keidanren, 2006).

The SII was not successful in terms of the basic objectives it had set out to achieve. There was some success in solving problems on the micro-level. Yet, the major macroeconomic issues that the U.S administration had been put under pressure to resolve in negotiations with the Japanese government still remained: Japan's trade surplus with the U.S. and the U.S. trade deficit with Japan had not altered with the

Japanese market still not fully open to foreign investors. It is of note that the bursting of the Japanese bubble economy in 1990 and the beginning of a recession had at this point in time not yet impacted upon the nature of the relationship between the U.S. and Japan. The incoming Clinton administration thus needed to urgently address the Japan problem (Tsushima, 2006, p.131). The next section of the chapter focuses on the attempts of the Clinton administration to engage in trade negotiations with the Japanese government and aims to gain insights into the debate over corporate governance in the context of the new U.S. administration.

7.2.2. Japan-United States Framework for a New Economic Partnership: The Framework Talks (1993-1995)

The Clinton administration, being aware that the *Structural Impediments Initiative (SII)* had not achieved significant results for the U.S., began negotiations with the Japanese government in which it pursued a strategy of getting the Japanese government to accept numerical targets (Tsushima, 2006, p.131). A new agreement with Japan, the *Japan-United States Framework for a New Economic Partnership* (Framework)[98], was negotiated. This framework was agreed by President Clinton and Prime Minister Miyazawa in their meeting in April 1993. The goals of the *Framework* were set out in a joint statement as follows:

> The Framework provides a structure for an ongoing set of consultations anchored in biannual meetings of the Heads of Government. The goals of

[98] The *Japan-United States Framework for a New Economic Partnership* (1993) is in the following referred to as *Framework.*

> this Framework are to deal with structural sectoral issues in order subsequently to increase access and sales of competitive foreign goods and services through market-opening and macroeconomic measures; to increase investment; and to promote international competiveness; and to enhance bilateral economic cooperation between the United States and Japan.

The above statement reflects U.S. concern – as in the case of the SII – to achieve the further opening of the Japanese market to U.S. firms and investors and to reduce the trade imbalances between the two countries. The following commitment for Japan was outlined in the *Framework*:

> Japan will actively pursue the medium-term objectives of promoting strong and sustainable domestic demand-led growth and increasing the market access of competitive foreign goods and services, intended to achieve, over the medium term, a highly significant decrease in its current account surplus, and to promote a significant increase in global imports of goods and services, including from the United States (Framework).

The *Framework* outlines areas of Sectoral and Structural Consultations and Negotiations, such as, for example, Government Procurement, Regulatory Reform and Competitiveness and Economic Harmonization. Specific arrangements made under the *Structural Impediments Initiative (SII)* are to be absorbed into the areas covered by the *Framework* as appropriate. The *Framework* states that these areas will have working groups attached, which consider issues in detail. The area of particular interest in the context of corporate governance is *Regulatory Reform and Competitiveness* and its respective working group. Before an analysis of some of the documents, which were issued under the auspices of the *Working Group on Regulatory Reform and Competiveness* is provided, a brief discussion of the difficulties the Clinton administration experienced when changing its negotiating strategy - from the Bush approach of emphasising macroeconomic issues to an approach of setting precise targets in specific areas of the Japanese economy - is offered. Insights into these issues provide interesting instances of resistance on the part of the Japanese government to proposals made by the U.S. government.

Tensions soon arose between the negotiating partners because of the changes in the U.S. negotiating strategy and the new emphasis on targets. The Japanese government wanted to negotiate issues in an abstract way rather than negotiating issues on an individual basis as it was of the opinion that structural negotiations do not require specific numerical targets.[99] Satake (1994, 2000) argues that this difference in negotiating style reflected the different positions of the Republican Party and the Democratic Party in terms of trade policy, namely, free trade versus protective trade. Reflecting the Democrats' principle of protective trade, President Clinton extensively pressurised Japan to open its market, threatening to invoke Section 301 of the 1988 *Omnibus Trade and Competitiveness Act* (Satake, 1994, 2000). According to Satake (2000) and Shimizu (2007), the U.S. required the setting of a numerical target on each of the issues under discussion. The Japanese government, however, refused to set such targets, and the Japan-US summit meeting, which took place in January 1994, failed to come to an agreement over the setting of the targets (Shimizu, 2007). As no agreement had been reached on the automobile and automobile parts area at the summit meeting, President Clinton revived Section 301 of the 1988 *Omnibus Trade and Competitiveness Act* in order

[99] Satake (2000, p. 73) points out that the Japanese government seemed to anticipate that the Clinton administration would introduce its strategy of emphasising targets.

to adopt a hard-line attitude towards Japan (Tateyama, 2005, p.172). Satake (2000) argues that the U.S. strategy towards Japan seemed to have been affected by the refusal of the Japanese government to accept numerical targets in the negotiations and by its subsequent appeal to the *World Trade Organisation* (WTO) about the U.S. sanctions that had been imposed. This approach of the Japanese government was a change in strategy away from bilateral negotiations to multilateral negotiations utilising the WTO (Satake, 2000; Wakasugi, 2007). The Clinton administration's aggressive foreign policy towards Japan was criticised by other Asian and European countries (Satake, 2000, p.84). Within Japan there was also criticism of the way the Japanese government had dealt with the demands of the U.S. administration. Critics within had argued that although Japan had refused to set numerical targets the actions taken by the Japanese government had not been appropriate (Ikejima, 1994; Tateyama, 2005, Shimizu, 2007).

The Japan-US Framework for New Economic Partnership (*Nichibei Houkatsu Keizai Kyougi*) was concluded in 1995 with agreements reached in some areas. Agreements in the automobile area and automobile parts, however, could not be reached, which resulted in the above crisis.

This crisis was subsequently resolved in high level meetings with Hashimoto, the Minister of International Trade and Industry, and Kantor, the Head of *United States Trade Representative* (USTR), compromising their claims. Having reached an agreement in most areas, including government procurement of medical equipment, telecommunications and financial services (Satake, 2000, pp.75-76), the *Japan-US Framework for New Economy Partnership* (*Nichibei Houkatsu Keizai Kyougi*) was terminated in 1995. Both governments, however, agreed to continue the dialogue on deregulation and competition policy. Many of the issues addressed in the *Japan-US Framework for New Economy Partnership* (*Nichibei Houkatsu Keizai Kyougi*), however, remained unaddressed. Both governments did agree to monitor the degree of implementation of the issues that had been agreed in the negotiations (Satake, 2000). Having provided a brief summary of some of the main issues of conflict in the bilateral trade negotiations under the Clinton administration an analysis of documents issued in the context of the bilateral trade negotiations during the Clinton era is offered below so as to bring out developments and changes in the debate.

The U.S. government made annual recommendations [100] regarding issues of deregulation and administrative reform in Japan to the Japanese government in the context of the *Deregulation and Competition Policy Working Group*, which had been established under the *Framework* (Submission, 1994). The *Submission* of 1994 was written in a context where Japan, in the process of 'formulating a five-

[100] The annual recommendations, entitled *Submission by the Government of the United States to the Government of Japan Regarding Deregulation and Administrative Reform in Japan*, are in the following referred to as *Submission*. Since the Submission in 1994, the U.S. government has issued recommendations and requests on an annual basis. These recommendations were issued even as new initiatives were launched and the Clinton administration was superseded by the Bush administration in 2001. In the context of new initiatives the titles of the Submissions were changed so as to reflect the new initiatives (see Table 10). The submissions of the U.S. government over the period from 1994 to 2007 and the reports of the actions taken by the Japanese government in light of the submissions are one part of the empirical focus of the remaining part of the chapter. The other part of the empirical focus are the documents published in the context of specific initiatives. The emphasis in the analysis is on the way in which corporate governance issues feature in these documents.

year deregulation action programme'[101], had asked foreign governments for inputs regarding deregulation matters (Submission, 1994). In its *Submission* the U.S. government states:

> The attached paper is intended as an initial list of proposals and requests made by the Government of the United States. Because deregulation needs to be an ongoing process responsive to the ever-changing marketplace, the United States may submit additional requests or proposals as the Government of Japan continues the process of formulating and implementing the action progam (Submission, 1994).

The *Submission of 1994* sets out recommendations regarding basic principles and the deregulation process as well as 'deregulation proposals' for specific sectors, such as, for example, 'Agricultural-Related, Automobile and Automotive Parts, Construction Materials, Distribution-Related, Energy Production and Delivery, Financial Services and Telecommunications/Information Systems' (Submission 1994). This detailed listing of specific areas is indicative of a change in policy away from an emphasis on general macro-economic issues towards a more specific targeting of what were perceived to be problem areas. The Submission of 1994 contains no specific reference to issues related to corporate governance. The Submission of 1995,[102] however, makes reference, although limited, to some characteristics of the Japanese business context and of corporate governance. In the *Framework Agreement* both governments had negotiated the deregulation of the Japanese insurance sector, which included 'measures relating to the distribution and purchase of insurance within "*Keiretsu*" groupings...and a variety of measures

[101] The Japanese government intended to finalise its deregulation action programme by March 1995.
[102] "*Submission 1995*" refers to *Submission of the Government of the United States to the Government of Japan Regarding Deregulation, Administrative Reform and Competition Policy in Japan (1995).*

related to transparency' (Submission 1995). In its submission, the U.S. government announced that its 'focus, in the near term, will be on the effective implementation of this agreement' (Submission 1995). The *Submission* of 1996 contains more detailed and specific recommendations. Of interest in terms of corporate governance is that disclosure and accounting practices are recommended for the financial services sector: 'Enhance financial disclosure and accounting standards, as well as transparency of the financial regulatory process' (Submission 1996). In its *Submission* in 1997, the U.S. government states that deregulation of the Japanese financial services sector so far has been 'very satisfactory' and maintains that the '[t]he measures and liberalizations carried out under the agreement have resulted in substantially improved commercial opportunities for foreign financial services providers in the Japanese market' (Submission 1997, p. 6). The U.S. government, however, advocates that there is a need for 'improved transparency in the financial services sector' and recommends that the government of Japan should:

> Adopt international standards in the design and tax treatment of financial instruments so as to encourage the widest possible internationalization of, and foreign participation in, the Japanese financial market (*ibid.*)

The reference to international standards of accounting in the context of financial instruments indicates that these standards are seen as playing a vital role in encouraging foreign investment.

7.2.3. U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (Enhanced Initiative) (1997)[103]

In 1997 Prime Minister Hashimoto and President Clinton launched a new initiative, the *U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (Enhanced Initiative) (Nichibei Kisei Kanwa Taiwa).*[104] Both countries agreed to set up working committees in each of the areas that formed the basis of the negotiations (for example, information technology, telecommunications and agriculture). The negotiations focused on the micro-level rather than the macro-level, which was different from the approach taken in the case of the SII (Yamazaki, 2006, p.1). Yamazaki (2006, p. 9) argues that this time such an approach did not cause tensions because of the booming economy in the U.S. and the low standing of Japan as a trade partner and Japan's continuous commitment to economic reform (Yamazaki, 2006, p.9). Further, another important contextual factor shaping the bi-lateral trade negotiations was a push towards further liberalisation and marketisation on the part of the Japanese government between 1996 and 1998 (the so-called Japanese Big Bang; see, for example, Hall, 1998, 139-158; Hoshi and Kashyap, 2001, pp. 267-304), a move especially welcomed by the U.S government. The *Second Joint Report* (1999) refers to the progress made by the Japanese government in terms of the deregulation of the financial system:

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[103] The *U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy (Enhanced Initiative)is in the following referred to as Enhanced Initiative.*

[104] During this initiative joint status reports were issued after the end of each annual cycle, which summarised the progress made by both governments in implementing the measures of the *Enhanced Initiative* and outlined any measures that still needed to be taken. The U.S. government also continued its *Submission* to the Japanese government under the *Enhanced Initiative* (see Table 11).

> The Japanese financial system reform program (the so-called Japanese "Big Bang"), which was started at the initiative of former Prime Minister Hashimoto in November 1996, aims at revitalizing the Japanese financial markets through fundamental financial liberalization and deregulation based upon the principles of "Free, Fair, and Global." The Financial System Reform Law, which incorporates most of the measures in the reform, went into effect on December 1, 1998. The Government of the United States welcomes this progress.

In terms of financial disclosure, which was the main corporate governance issue of the first few years of the new initiative, this meant:

> Enhanced disclosure by financial institutions to market participants, such as adoption of disclosure standards for non-performing loans similar to those of the U.S. Securities and Exchange Commission (phased in from the business year beginning on and after April 1, 1997) (Second Joint Report, 1999, p. 11).

And:

> Enhancement of the disclosure such as shift to the framework of the disclosure primarily based on consolidated accounting (phased in from the business year beginning on and after April 1, 1998) (*ibid.*, p. 12)

The above developments indicate a further move towards convergence in the area of accounting disclosure.

Of particular interest in terms of possible challenges to the Japanese corporate system and the Japanese corporate governance system in the context of the bi-lateral trade negotiations is the following passage from a joint statement by the U.S. and Japan:

> In today's increasingly integrated world economy, it is becoming more important to address consumers' interests in expanded choices of products

> and services that are readily available at lower prices, through enhanced competition and improved market access opportunities. With a view to meeting consumers' interests and to improving market access for foreign companies and foreign goods and services, the President and the Prime Minister decided in April 1997 to strengthen the dialogue between and reinforce the efforts of their governments with regard to deregulation and competition policy under the US-JAPAN *Framework for a New Economic Partnership* ("*Framework*"). This Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative") is intended to carry out that decision.

As Iha (1991) has argued the emphasis on consumers is a Western emphasis and challenges the Japanese emphasis on the company, which in Japan is an implicit emphasis on employees (cf. Dore, 1998). The focus on consumer interests as well as the previously introduced focus on shareholder interests potentially further challenges Japanese corporate systems and institutions. Emphasising consumer interests can also be seen as a further move towards an Anglo-American market philosophy in which consumers play an important role in facilitating the functioning of the market mechanism (Iha, 1991).

A significant shift in the bi-lateral trade negotiations, in terms of how corporate governance issues were discussed, occurred in 2000. In this year the U.S. government mentioned the term "corporate governance" for the first time in its *Submission* (Submission, 2000). This constitutes a shift away from a narrow focus on accounting disclosure as one component of the corporate governance system to the broader concept of corporate governance of which accounting disclosure is an important part.[105] There is another significant shift that can be observed in the

[105] This is the case even if in subsequent submissions disclosure requirements in the context of financial services were still discussed.

Submission of 2000: corporate governance issues are no longer discussed in relation to one particular sector (mainly the financial sector in previous documents) but for the corporate sector as a whole. This shift in focus can be explained with reference to a major development in the regulatory framework, namely the Japanese government's revision of the *Commercial Code*.[106] The U.S. government highlights the significance it attributes to the *Commercial Code* in its *Submission* of 2000:

> The Commercial Code plays a central role in ensuring a positive business climate in Japan for both domestic and foreign firms. Revision of the Commercial code will have a profound effect on the ability of firms to structure themselves effectively for modern capital markets and to operate efficiently. If done, correctly, revision of the Code should introduce greater flexibility in the organization, management and capital structure of companies, and improve their efficiency and accountability. The revision will also have key implications on the ability of foreign firms to enter and operate in the Japanese market. Implementation of these improvements to the Commercial Code should have positive effects on revitalizing Japan's economy, and therefore should be adopted with the earliest possible effective dates within Japan's fiscal 2002.

Although the U.S. government stresses that the revision of the *Commercial Code* if done properly (i.e. according to Western capitalistic principles, such as, efficiency and flexibility) will help Japan to improve its economic situation, it is evident that the U.S is itself interested in the opening up of what are perceived from a Western perspective to be 'secure' and 'safe' places for Western investors and firms. The implications of what is suggested in the above quotes are significant for the Japanese context. For example, 'the ability of firms to structure themselves effectively for modern capital markets and to operate efficiently' implicitly

[106] The reform of the *Commercial Code* was scheduled to be completed in 2002.

challenges the Japanese concept of the community firm with its emphasis on employees and long-term growth rather than an emphasis on efficiency with a view to maximisation of profit short-term. Further, modern capital markets referred to in the statement by the U.S. government refers to capital markets reflecting Anglo-American capitalism and its inherent values, i.e. an emphasis on management operating in the interests of shareholders rather than as in the Japanese context where there is a greater emphasis on management operating in the interests of employees (Dore, 1998; Inagami and Whittaker, 2005). The recommendations of the U.S. government thus constitute a significant threat to characteristics of Japanese management practices (for example, life-long employment and seniority based pay) and its corporate system. For the U.S. government, as evident in the above citation, the revision of the *Commercial Code* constitutes an opportunity 'to remove the substantial impediments to investment and financial transactions in the current Code and to make corporate management more accountable and efficient' (Submission 2000, p. 46). The reference to accountability here has to be understood in the Western context, namely accountability to shareholders. If one looks at the accountability of management of a Japanese firm from a Japanese perspective then accountability in practice would mean accountability to employees (Inagami and Whittaker, 2005). Further, the call for efficiency by the U.S. government seems to be somewhat displaced in the Japanese business context where long-term survival of the firm and life-long employment are the objectives that managers have to pursue: the Western context of efficiency in the Japanese context seems to thus be somewhat misplaced and irrelevant.

The U.S. government in its recommendations urges the Japanese government:

> ...to ensure that Commercial Code revision takes full account of global trends in corporate governance and transactions and to incorporate greater flexibility now to anticipate future trends, the Japanese government should provide for broad participation in the revision process by both domestic and foreign interests affected by the revisions (Submission 2000, p. 46).

Again, recommending to the Japanese government to 'take full account of global trends in corporate governance' can be read as suggesting that the Japanese government should take full account of the Anglo-American corporate governance system, which has achieved a hegemonic position globally. It is thus reasonable to argue that the U.S. government in the context of bilateral trade negotiations has put significant pressure on the Japanese government to change the traditional Japanese corporate governance system to reflect the Anglo-American corporate governance system.

The U.S. government was quite specific in its recommendations regarding the revision of the Japanese *Commercial Code*. It recommended that the following items needed to be considered: corporate capital structure; corporate governance; shareholder derivate legislation; facilitating corporate transactions and public input into the *Commercial Code* revision process (Submission 2000, pp. 46-49). The detailed recommendations again constitute threats to traditional Japanese practices. Interestingly, accounting disclosure is seen as an important means to protect shareholder and markets. In this context, the U.S. government recommends that the Japanese government:

> Eliminat[es] many of the current restrictions on a company's capital structure, relying instead on improved corporate disclosure – such as through new accounting standards and the Securities Exchange Law – to address shareholder and market protection concerns (*ibid.*, p. 46).

In relation to corporate governance, the U.S. administration focuses on the following key items of the Anglo-American corporate governance system: the composition and role of the board of directors; the role of independent directors; shareholder meetings; the disclosure of information; and incentive structures. The U.S. government 'recommends that the Japanese Government ensures that [these] items are addressed in the revision' (*ibid.*, p. 46).

The U.S. government highlights the importance of 'increasing the independence, responsibility and accountability of corporate boards, including by adopting enabling mechanism and establishing appropriate incentives' (*ibid*, p. 47). The suggestions concerning the composition of the board of directors, i.e. increase the number of independent directors on the board, reflects the Anglo-American perception that independent directors are an important, if not most important, control mechanism or monitoring mechanism in the context of the corporate governance system (Mallin, 2007). This emphasis on the control role or monitoring role of independent directors is also reflected in the recommendation that '[b]oard committees composed of independent directors' should be introduced, which would make decisions on important governance items such as compensation, nomination of officers and directors, and audits' (*ibid.*, p. 47). Further, reflecting Anglo-American views, the U.S. government also recommends incentive structures to encourage the introduction of such committees:

> Incentives to use such committees could be in the realise from other mechanisms that serve the same purpose. For example, a company opting to have an audit committee of independent directors would not need to have statutory auditors (kansayaku). This change would be part of a general effort to make corporate management more transparent, accountable and efficient (*ibid.*)

With regard to shareholder rights it is recommended that the Japanese government take 'measures to ensure that shareholders meetings for public companies are scheduled on dates which are not clearly inconvenient for many shareholders to attend' (*ibid.*). In terms of disclosure, the U.S. government suggests:

> ...[i]ncreasing the information that publicly listed companies are required to disclosure and make available to shareholders, directors and auditors. Consistent with the OECD Principles of Corporate Governance, at a minimum, corporations should disclose information, the omission of mis-statement of which would influence the economic decisions taken by users of that information (*ibid*, p. 48)'.

Of interest is the way in which the U.S. government recommends that the *Commercial Code* should be revised:

> Revising the Commercial Code so that it flexibly enables and supports market-driven transactions, rather than set overly proscriptive rules for both governance and transactions...(*ibid.*).

One example of such an approach would be:

> Requiring the use of outside statutory auditors (*shagai kansayaku*) for those publicly listed companies that choose to retain the "kansayaku"

> system rather than using an audit committee of independent directors (*ibid*).

Reliance on incentives and market mechanisms' again reflects the Anglo-American context and challenges the traditional Japanese reliance on government regulation through the law (Oguri and Hara, 1990). This is also evident in the recommendation regarding the regulation of the disclosure of accounting information. The suggestion is made to the Japanese government to:

> ...[s]upplement recent progress in adopting internationally acceptable accounting standards with strict enforcement of the implementation of those standards (through outside audits and proactive government supervision) in order to ensure that a financial statement accurately represents the financial position of a company. Provide the flexibility in the Commercial Code to allow for the establishment of rules consistent with internationally acceptable accounting standards without necessitating further changes to the Code itself (*ibid.*, p. 49)

The emphasis on 'internationally acceptable accounting standards' – IASs and IFRSs - again has to be read as 'Anglo-American' (Gallhofer and Haslam, 2007). The suggestion that there should be the possibility of establishing accounting rules without the due process of changing the *Commercial Code* indicates a move away from the traditional Japanese mode of regulating the disclosure of accounting information, i.e. through the state, to a mode in which private sector bodies and the accountancy profession would be the dominant forces (Puxty et al., 1987). Again, this reflects the way in which the disclosure of accounting information is regulated in the Anglo-American context. Such a move would thus further reduce the control of the Japanese government in a socially and economically important area.

There is no response in the *Fourth Joint Report* (June 2001) to these extensive corporate governance recommendations made by the U.S government in October 2000. One reason for this is probably that the work of the committee was interrupted by events in the political context of the U.S. 2001 saw a change in government in the U.S. - the Clinton administration was superseded by the Bush administration. Another, and similar, reason might have been a change of Prime Minister in Japan with Prime Minister Koizumi taking office in August 2001 (Cargill and Sakamoto, 2008, p. 17). Prime Minister Koizumi's term of office had a significant impact on the Japanese economy and on Japanese society. Although the party in power did not change with the election of Koizumi to Prime Minister, policies did change significantly because of the political position of the new Prime Minister, who was a strong proponent of market liberalisation (*ibid.*).

7.2.4. U.S.-Japan Economic Partnership for Growth (Partnership) (2001-2007)

The Bush administration quickly resumed its engagement with Japan. President Bush and Prime Minister Koizumi launched a new partnership, the *U.S.-Japan Economic Partnership for Growth (Partnership)* (June 2001).[107] In the context of the *Partnership* the *Enhancement Initiative* (previously negotiated by the Clinton administration in 1997) was replaced by the *Regulatory Reform and Competition Policy Initiative (Reform Initiative)* (*Nichibei Kisei Kaikaku oyobi kyousou Seisaku Inishiachibu)* in June 2001, which was 'designed to promote economic growth by

[107] This agreement is in the following referred to as *Partnership*.

focusing on sectoral and cross-sectoral issues related to regulatory reform and competition policy' (Partnership, p. 2). The *Reform Initiative* issued annual reports [108], which outlined progress made during the annual cycle. The U.S government continued to issue its recommendations to the Japanese government regarding its regulatory reform but under the new title of *Annual Reform Recommendations from the Government of the United States to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative.* [109] In terms of corporate governance issues, it is of interest to gain insights into what issues the *Annual Reform Recommendations* highlighted as necessary to be considered by the Japanese government in order to improve the Japanese corporate governance system and how the Japanese government responded to these requests. The responses of the Japanese government may be ascertained from the annual reports for each Regulatory Reform Initiative Cycle. In the following, an analysis is offered of these issues raised by the U.S. government and the reactions of the Japanese government for the period from 2001 to 2007.

In its *Annual Reform Recommendation* of 2001 the U.S. government again highlighted the need for the Japanese government to strengthen the Japanese corporate governance system. It particularly stressed that Japanese companies should have the option to adopt an Anglo-American corporate governance system:

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[108] These annual reports, which were issued as *Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative* are referred to in the following as *Reports*.
[109] These documents are in the following referred to as *Annual Reform Recommendations*.

> Provide publicly traded companies the option of adopting a corporate management structure that includes an executive office system and a board committee system in which at least the audit, nomination and compensation committees include, at a minimum, a majority of outside directors, instead of continuing to use the traditional *kansayaku* (statutory auditor) system (Annual Reform Recommendation 2001, Annex – 35).

The U.S. government further requested that the term 'outside director' be carefully defined and recommended that the Japanese government:

> ...[m]odify the definition of "outside directors" to ensure that such directors are truly "independent", including by excluding employees and ex-employees of companies with significant cross-shareholders with, or in the same *keiretsu* as, the company (Annual Reform Recommendation 2001, Annex – 35).

The U.S. government's concern with *keiretsu* has been evident since the first document issued in the context of the *Structural Impediments Initiative* in 1989. Although concerns about their disclosure practices had been satisfactorily addressed by the Japanese government during the bi-lateral trade negotiations and the way it had dealt with the issue of cross-shareholding had not so far met the expectations of the U.S. government. The above quote of the U.S. government is of particular interest as it indicates that a change in the Japanese corporate governance system, i.e., the particular definition of 'truly "independent"' (Annual Reform Recommendation 2001, Annex – 35) would constitute a challenge to a key component of the Japanese corporate system.

The First Report to the Leaders on the U.S.-Japan Regulatory Reform and Completion Policy Initiative (2002) provides a summary of how the Japanese government had addressed the U.S. recommendations on corporate governance. The Report stated that the 'Commercial Code was amended to':

> Introduce a new system of corporate governance, consisting of the board of directors, executive or corporate officers, and three committees (the audit committee, nominating committee, and compensation committee) composed of at least a majority of outside directors, for large corporations. If a corporation chooses the new system, there is no requirement to have statutory auditors (*Kansayaku*). This new system enables the board of directors to properly delegate substantial management authority to officers (Report 2002, p. 33).

As is evident from the above statement the Japanese government allowed companies to introduce an Anglo-American style corporate governance system. It is of interest to note that the 'flexible approach' that the U.S government had referred to in its 2002 Submission (*supra*) had been applied in revising the *Commercial Code* as the Code now gave companies the *option* to change their corporate governance system rather than *requiring* them to change it. The Japanese government thus had left it to 'market mechanisms' to provide incentives to companies to adopt Anglo-American style corporate governance. Further, the Japanese government confirmed that it 'will continue to implement high quality, internationally acceptable accounting standards' and also strengthen the enforcement of such rules (*ibid.*). The inclusion of the Anglo-American corporate governance system into the *Commercial Code* in addition to the traditional Japanese corporate governance model was portrayed as a major success for the Bush junior administration. This success, however, it can be argued, has been especially possible because Prime Minister Koizumi himself was influenced by neo-liberalism. Cargill and Sakamoto (2008, p. 202) argue that Koizumi's 'policy platform was similar to the market reform and deregulation carried out by Margret Thatcher in the United Kingdom and Ronald Reagan in the United States in the 1980s' and explain that:

> ...[t]he central themes of Koizumi's freeform programs were small government, deregulation, liberalization, privatization, and devolution. These reforms would transform the Japanese economy into a more open and flexible market economy with less government intervention and regulation, in which free-acting economic actors drive innovation, investment, and economic growth through market competition. Typical of conservative or neoliberal policy makers in other industrial democracies (not necessarily Japanese conservatives), Koizumi wanted to reduce government intervention and the amount of resources the government took from the private economy (Cargill and Sakamoto, 2008, p. 202).

It is of note that although the decision to allow Japanese companies to choose either the Japanese or the Anglo-American corporate governance system might have been motivated by a neoliberaal market philosophy, the way it worked out in practice ensured that the Japanese traditional corporate governance system remained the dominant corporate governance system by 2007 as only few companies chose to adopt the Anglo-American corporate governance system Yoshimori (2005, pp. 447-448) reported that in a survey carried out in May 2004 by the Japan Corporate Auditors Association '86% of member firms in the Japan Corporate Auditors Association...had expressed no intention of adopting this structure'.

In the following years up until 2007 the U.S. government in its *Annual Reform Recommendations* attempted to build on this success and to further refine and improve the Japanese governance system with reference to specific corporate governance items. The following key corporate governance items of the Anglo-American system were addressed during this period: active shareholder and proxy voting (adoption of proxy voting policies by pension funds and mutual funds, better disclosure of information to facilitate proxy voting; promotion of active shareholder, especially institutional investor, voting); protection of minority shareholders; protection of whistle blowers (changes in legislation to this effect); strengthening of the executive committee and corporate auditor system; and, definition of independent directors.

There are two issues in the *Annual Reform Recommendations* between 2002 and 2007 that are of interest in the context of aiming to gain insights into how the U.S. government recommendations threaten and challenge the traditional Japanese corporate governance system, the Japanese business context and Japanese culture more generally. Stressing the need for improved corporate governance in its *Annual Reform Recommendations* of 2002 the U.S. government suggested:

> Good corporate governance will lead to improvements in the performance of companies, as management strives to maximize shareholder value through increased productivity and sound commercial decisions. Ensuring that management is accountable to shareholders, through disclosure of information necessary for intelligent voting of proxies and encouragement of active shareholder voting; is one of the fundamental aspects of a good corporate governance system (Annual Reform Recommendations 2002, Annex – 33).

This statement is of interest as it links good corporate governance with the role of managers to maximise shareholder wealth. This statement implicitly suggests that any corporate governance system that does not ensure shareholder wealth maximisation is not a good corporate governance system. In other words, the traditional Japanese corporate governance system with its emphasis on long-term firm survival is by implication not a good corporate governance system. Defining the objective of the firm as shareholder maximisation thus potentially threatens the Japanese concept of the community firm and Japanese employment practices (such as life-long employment and seniority-based pay). Such a threat is also evident in the suggestions by the U.S. Government that the Japanese government should ensure that 'outside directors...[are]...truly independent' by:

> Revising the definition of 'outside director' in the Company Law to also exclude, at a minimum, persons who (i) have had significant transactions with the company or are employees of other companies that have a significant business relationship with the company, or (ii) have an immediate family member who has had significant transactions with the company or is an executive officer in a company that has an significant business relationship with the company;... (Annual Reform Recommendations 2007, Annex – 27).

7.3. SUMMARY DISCUSSION

This chapter has shown that from 1989 to 2007 the U.S. government had ostensibly put continuous pressure on the Japanese government to change its corporate governance system and adopt the Anglo-American model of corporate governance. The pressure to change the corporate governance system was articulated by the U.S. government in the context of a concern to achieve deregulation of the Japanese economy in order to gain access to the Japanese market for U.S. and other foreign investors and firms. Shimizu (2007, p. 33) argues that the structural reforms Japan was undergoing were not motivated from *inside* Japan but they were, disguised by a rhetoric of globalization, undertaken so as to converge the Japanese system towards the U.S. system (Shimizu, 2007, p.33).

It has been argued that the history of the bilateral negotiations between the U.S. government and the Japanese government is the history of Japan consistently making concessions in response to U.S. demands (Shimizu, 2007p. 27). Satake (1994) refers in this context to two interesting interpretations of Japan's positive response to U.S. pressure in the context of the SII. First, as Japan always appeared to yield to the demands of the U.S., the impression was created that Japan accepted U.S. demands without counter arguments. However, Japan's willingness to yield to U.S. demands can be interpreted as the Japanese government taking advantage of the pressure from the U.S. government (i.e. pressure from *outside*, *Gaiatsu*) to further pursue its own objective of market liberalisation and deregulation. In other words, the Japanese government used *Gaiatsu* as a rhetorical device to achieve its own objectives. Satake (1994) makes here the point that without *Gaiatsu* it would have been difficult for the Japanese government to achieve the market liberalisation that it was aiming for.

On the other hand, criticisms have been made that the U.S. government's attitude can be seen as interference into the internal affairs of another country and analyses were offered to show that this series of negotiations was intended by the U.S. government to achieve a reconstruction of the Japanese system along the lines of the U.S. system. The argument has a particular weight as various aspects of the Japanese system and of Japanese practices, which did not relate to the U.S. trade deficit problem, also became the subject of the U.S.'s unreasonable demands (Satake, 1994, p.117, Shimizu, 2007 p. 27). Shimizu (2007) argues that Japan's willingness to yield to U.S. pressure emanated from Japan's unique economic development model since the end of World War II with its excessive dependency on the U.S. in terms of trade and national defence (Shimizu, 2007, p.27). As Dore (2003) has pointed out 'trade dependencies are real dependencies'. It was in the context of the unequal power relationship between the U.S. and Japan that Japan's response to U.S. demands has to be understood (Suzuki, 1989, p.56).

Ikejima (1994) argues that SII recommendations were reflected in the revision of the *Commercial Code*, which took effect from 1st October 1993. In this respect he points to three issues in the amended *Commercial Code*: first, the reinforcement of the monitoring function by shareholders, especially minority shareholders; second, the strengthening of the audit function; third, the revision of the corporate board system. The revised *Commercial Code* contained simplified class action lawsuit procedures (i.e. reduction in costs), the extension of the term of a corporate auditor, an increase in the number of corporate auditors in large companies and the establishment of external auditors and a board of corporate auditors (Ikejima, 1994, p.75). For Ikejima (1994), the changes in the revised *Commercial Code* indicated that the Japanese government had accepted the U.S. demands. Demise (1997, p. 13) also holds that the extension of the term of corporate auditors, an increase in the number of corporate auditors in large companies, the establishment of external auditors and the board of corporate auditors were the result of the U.S. pressure (*Gaiatsu*). Kikuchi (1991) refers to the Bill for amending the *Securities and Exchange Law*, which was passed on 15th June 1990 and was promulgated 22nd June 1990, as evidence of the Japanese government taking into account U.S. recommendations. An important aspect of this revision of the law was the set of regulations concerning mergers and acquisitions. As the U.S. government had been interested in increasing direct investment in Japan it had been keen to improve the information disclosure in the context of takeover bids (Kikuchi, 1991, p.51). Tateyama (2005) points out that the U.S. had identified over two hundred structural items in the context of the SII negotiations, which it had required the Japanese government to address and that the Japanese government generally accepted these suggestions. Further, Tateyama (2005, p. 171) concludes that the pressure of the U.S. administration on the Japanese government had facilitated the crisis of Japanese capitalism.

The next chapter of this study, chapter 8, focuses on the attempt of a private interest group, the *Japan Corporate Governance Forum*, to respond to the pressure to change the Japanese corporate governance system and to adopt the Anglo-American corporate governance system by establishing a set of Japanese *Corporate Governance Principles* that would constitute good practice.

CHAPTER 8

THE CORPORATE GOVERNANCE PRINCIPLES OF THE JAPAN CORPORATE GOVERNANCE FORUM

During the 1990s, the Japanese corporate governance system had become the focus of critique as a consequence, on the one hand, of developments in Japan, notably the economic crisis, corporate failures and corporate scandals (*supra*), and, on the other, a more general concern about corporate governance, which was at the time especially evident in the U.K. and the U.S. (see, for example, Mallin, 2007; Solomons, 2007). Much of the critique of the Japanese corporate governance system from outside of Japan especially reflected a particular perspective, which took as its benchmark the Anglo-American model of corporate governance. Comparing the Japanese system of corporate governance with what was perceived in this perspective to be a more effective and thus better UK/US model led to an increase in argumentation that Japanese companies should be required to especially adopt the Anglo-American model of corporate governance (Yoshikawa and Phan, 2003; Egawa, 2005). Seki (2005) has pointed out that the contextual developments and the wider global debate about corporate governance issues increased the awareness of Japanese managers of the importance of corporate governance: for Seki (2005), public officials and corporate executives began to understand that good corporate governance practices can strengthen corporate competitiveness and also contribute to attracting foreign investors to the Japanese capital market. It was in this context of crisis and global pressure to change Japanese corporate governance practices and the increased appreciations of the importance of good corporate governance practices by Japanese managers that the *Corporate Governance Forum of Japan*, which was later renamed the *Japan Corporate Governance Forum*,[110] was founded in 1994.

The *Japan Corporate Governance Forum* is the focus of the analysis offered in this chapter, which aims to gain insights into how the above pressures for change and their associated challenges to national cultural values impacted upon and were reflected in the development of a set of *Corporate Governance Principles* for Japanese companies that the *Japan Corporate Governance Forum* had issued during the period from 1997 to 2006. The structure of the chapter is as follows: brief overview of the history and the aims and objectives of the *Japan Corporate Governance Forum*; analysis of the initial draft and the various revisions of the *Corporate Governance Principles;* and, critical elaboration upon the main insights that can be gained from the analysis of the development of the *Corporate Governance Principles.*

8.1. *NIHON COPOREITO GABANANSU FORAMU (JAPAN CORPORATE GOVERNANCE FORUM)*

In 1994 the *Japan Corporate Governance Forum* was established as an organisation comprising academics and business people. Ariyoshi Okumura from

[110] In this study the current name "*Japan Corporate Governance Forum*" is used throughout for reasons of clarity.

the Industrial Bank, who was a member of the *Japan Corporate Governance Forum,* explained that Kaneo Nakamura, his mentor and a member of the board of General Electric had made him realise that it was necessary to change the Japanese corporate governance system. Nakamura had gained his insights in terms of the importance of corporate governance from a stay in the U.S. (Jacoby, 2007, p. 8). Tadao Suzuki, the Chairperson of the later *Committee for the Settlement of Corporate Governance Principles*, describes the impetus for the formation of the *Japan Corporate Governance Forum* as follows:

> Early in 1994, when corporate governance was still not a major topic of discussion, Mr Kaneo Nakamura, Counsellor of The Industrial Bank of Japan, invited a number of senior businessmen to debate the issues..., and myself. We stayed one weekend at Tokyo Bay Hilton Hotel in Uraysu, and discussed and exchanged views on corporate governance day and night (Suzuki, 1998, p. 33-34).

As a consequence of these initial discussions 'The *Japan Corporate Governance Forum* was formally inaugurated in November 1994' (Suzuki, 1998, p. 34). The inaugural co-chairpersons were Mr Kaneo Nakamura, representing the business world, and Dr Takayasu Okushima, President of Waseda University, representing the academic world (*ibid.*). The forum was concerned to contribute to the corporate governance debate through proposing corporate governance principles that would through discussion develop 'into a "Code of Best Practice"' (Suzuki, 1998, p. 35). Suzuki describes the process as follows:

> In December 1996, the forum decided to draw up and propose its *Corporate Governance Principles of Japan*. I was designated Chairperson of the *Committee for the Settlement of Corporate Governance Principles*, which comprised seventeen participants, drawn from forum members representing corporate executives, institutional investors, law and

> economics academics, the mass media and lawyers. The committee has met 22 times in total between January 1997 and April 1998. Twelve of these meetings were held after the publication of the *Corporate Governance Principles – Interim Report* on October 30th of 1997, their aim being to hear and consider opinions and critiques of the report from domestic and overseas bodies.

The above statement is of interest as it clearly sets out the process envisaged in arriving at the *Corporate Governance Principles*. Further, it gives insights into how a private sector body, initiated by industry, aims to get legitimacy as a guardian and regulator of "best practice" through the inclusion of various constituencies in the decision making process.[111] The *Committee for the Settlement of Corporate Governance Principles*, for example, included not only those who were directly affected by corporate governance mechanisms in the day to day running of companies but also those who were critics of the current system, for example, the mass media. In addition, the *Committee* also included experts in state regulation, i.e. lawyers. The inclusion of institutional investors reflects concerns raised about the Japanese corporate governance system by especially those subscribing to a UK/US version of corporate governance. Of particular interest is the strong representation of academics on the *Committee,* which indicates the important role of academics in policy making in Japan. There was also a concern that not only domestic but also overseas bodies would comment on the proposed principles. *The Japan Corporate Governance Forum* issued several versions of its *Corporate Governance Principles*, which are discussed below.

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[111] Constituencies commenting on the draft included, for example, corporate auditors, academics, Australian Institute of Company Directors, Director of Coopers and Lybrand, Head of Investment Affairs – Association of British Insurers (U.S.A.), Vice President & Chief Strategist, Goldman Sachs (Japan) and Chairman of the OMRON Corporation. In addition, there were comments from 'others who chose to remain anonymous' (Final Report, 1998, pp. 57-58).

8.2. ANALYSIS OF THE CORPORATE GOVERNANCE PRINCIPLES AND THEIR DEVELOPMENT

The *Japan Corporate Governance Forum* issued four documents during the period from 1997 to 2006, which are listed in Table 11.

Year	Japanese Name of Document	English Name of Document
1997	*Koporeito Gabanansu Gensoku – Atarasii Kigyoutouchi wo Kangaeru- (Chūkan Houkoku)*	"*Corporate Governance Principles* – A Japanese View" (*Interim Report*)
1998	*Koporeito Gabanansu Gensoku – Atarasii Kigyoutouchi wo Kangaeru- (Saishū Houkoku)*	"*Corporate Governance Principles* – A Japanese View" (*Final Report*)
2001	*Kaitei Koporeito Gabanansu Gensoku*	"Revised *Corporate Governance Principles*"
2006	*Shin Korporate Gabanansu Gensoku*	"*New Corporate Governance Principles*"

Table 11: Development of the *Corporate Governance Principles*

Below the four versions of the *Corporate Governance Principles* are analysed. For each version an overview of the content is provided, which is followed by an analysis of the key issues addressed in the documents. An emphasis in the analyses is on the similarities and differences between the Japanese corporate governance system and corporate system and the Anglo-American corporate governance system and corporate system.

8.2.1. "Corporate Governance Principles – A Japanese View" (Interim Report)

The first publication of the committee was an *Interim Report* published on 30 October 1997 (Interim Report, 1997). The *Interim Report* consisted of four sections: first, an 'Introduction', which provided some insights into the importance of globalisation and some of the characteristics of the Japanese corporate governance system and corporate system; second, a section on the 'Japanese Corporate Governance System', which listed the main areas that needed attention; third a section on 'Accountability and Disclosure', which elaborated these issues in the context of corporate governance, and, fourth, a section on 'Governance Structure', which highlighted the key components of a governance structure. Sections 1 and 2 are introductory and explanatory, whereas Sections 3 and 4 are prescriptive and offer sixteen *Corporate Governance Principles* (Interim Report, 1997, pp. 2-10). Suzuki, the Chairperson of the *Committee for the Settlement of Corporate Governance Principles* explained the aims of the Principles as follows:

> Our "16 Standard Principles" are aimed at positioning entrepreneurs and the board of directors at the heart of the corporate governance debate, and will give us appropriate standards against which we can judge ourselves (Suzuki, 1998, p. 34).

The *Interim Report* offered a 'two-step formula for realising effective corporate governance'. The two steps were expressed in two categories of principle:

- Principles that should be adopted in approximately five years, along with legal reforms, are "Step A Principles",...

- "Step B Principles" are those which should be aimed for in the early 21st Century, are necessary (with amendments) to illuminate the path towards the globalized market, and which require legal reform on a grand scale (Interim Report, 1997, p. 1).

The introduction of the *Interim Report* set out some key issues in relation to corporate governance, including, the globalisation of the economy, the emphasis on shareholders, the role of the board of directors, the contribution of employees in shareholder value maximisation and the role of the Japanese *shachō* (President of a Japanese company) (ibid., pp. 2-4). This general introduction was followed by a brief outline of problems of the Japanese corporate governance system that according to the *Japan Corporate Governance Forum* needed to be resolved. Specific problems were identified in relation to the dual structure of the 'conventional Japanese corporate governance model' (ibid. p. 5), i.e. the board of directors and the board of corporate auditors and some of the components of the Japanese corporate system, including the Japanese concept of the community firm and its objective and Japanese management practices. The sixteen *Standard Principles* reflect the above considerations in focusing upon disclosure and accountability to shareholders, the board of directors, the Auditors and board of corporate auditors and Shareholder meetings.

The *Interim Report* is of particular interest to this study here as it offers insights into the tensions between the conventional Japanese corporate governance system and the Anglo-American corporate governance system. These tensions reflect the different corporate and cultural contexts in which the two corporate governance systems are embedded. The *Interim Report* also indicates how certain aspects of the conventional Japanese corporate governance system were being replaced in the elaboration by aspects of the Anglo-American corporate governance system. In the following, the *Interim Report* is analysed so as to bring out these tensions. The analysis is divided into parts: first, an elaboration of key concepts and issues in relation to corporate governance as identified in the *Interim Report*; and, second, a discussion of how these issues are reflected in the proposed *Corporate Governance Principles*.

8.2.1.1. Key Concepts and Issues in Relation to Corporate Governance

The influence of globalisation on the debate about corporate governance in Japan is evident in the *Interim Report*. Indeed, reference is made throughout to globalisation in explaining the need for changes in the corporate governance system and in justifying the proposed principles. It is argued that the globalised market that Japanese companies are part of has replaced the national market place. There is a clear recognition and acceptance in the *Interim Report* that the success of Japanese companies is linked to their standing in the globalised market. The importance that is placed on the globalised market place is evident in that it is globalisation that is the focus of the first paragraph of the *Interim Report*:

> The globalization of the marketplace has ushered in an era in which the quality of corporate governance is a crucial component of corporate survival. The compatibility of corporate governance practices with global standards has also become an important part of corporate success. The practice of good corporate governance has therefore become a necessary

> prerequisite for any corporation to manage effectively in the globalized market. (Interim Report, 1997, p. 2)

Interestingly, effective and high quality corporate governance is linked to corporate success. This view reflects UK/US emphasis in the debate on corporate governance and attempts made especially by UK/US academics to empirically establish this link through their research.[112] Further, the recognition of the need to have national standards that are compatible with global standards points to the increased legitimacy that global standard setters, such as, for example, *The International Accounting Standards Board (IASB)*, are gaining worldwide. At the same time it also points to the increasing power that global standard setting bodies have over national standard setters (cf. Gallhofer and Haslam, 2006, 2007). As will be shown later, the need to comply with global standards seriously threatens national characteristics of governance systems, including their cultural specificities.

Key to the wider debate on corporate governance is the consideration of who has the right to govern the company and who do management have to be accountable to. There are two theoretical positions that can be found in such debates: one position holds that shareholders are the only group of importance here and the other points to the significance of a whole range of stakeholders. In line with such concerns found in debates more generally the *Interim Report* also addressed the shareholder/stakeholder issue:

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[112] A clear link between the quality of corporate governance practices and firm performance has, however, not been established by such research.

> The publicly owned corporation, a basic component of corporate society, is actually a system of cooperative relationships between various stakeholders, including shareholders, employees, clients, suppliers, creditors, and management. But shareholders in particular are given a special position. As owners of the company they are the last risk takers who are entitled to claim the residual profits of the company. Under the system of private ownership, shareholders are granted the right of governance over the company for the benefit of their own interests. This idea forms the foundation of the corporate governance concept (Interim Report, 1997, p. 2).

It is worthwhile to look more closely at how the shareholder/stakeholder issue is addressed in this quotation as it can give insights into particular tensions that might arise in aims to clarify the relationship between shareholders and other stakeholders. Interestingly, the first reference in this paragraph is to stakeholders. Indeed, it is the way in which stakeholders are variously interlinked that constitutes the publicly owned corporation. This particular system of relationships is described as being 'cooperative', a reference to working with each other rather than against each other. It is within this group of stakeholders that shareholders assume a special position because of their particular legal status as owners of the company, which implies that if something goes wrong shareholders are the stakeholder group that is most affected. Such argumentation, which is typically linked to agency theory, justifies the privileged role of shareholders and is referred to in the *Interim Re*port as 'the foundation for the corporate governance concept'. Although the *Interim Report* clearly points to the importance of shareholders in corporate governance, there are interesting tensions in its argumentation here, which point to different kinds of governance systems operating in practice. For example, the first reference in addressing the shareholder/stakeholder issue is to stakeholders and it is only within an understanding of the firm as being constituted of the relationships between various stakeholders that shareholders hold their special place as a privileged stakeholder group. In the section headed 'The Japanese Corporate Governance System: Problems to be Solved', the *Interim Report* points to two corporate governance systems, which are understood to be opposites:

> The European (Continental)/Japanese model vs. the Anglo-American model:
>
> - the concept of the company as a community vs. the concept of the company owned and governed by shareholders, who are the last risk takers. (Interim Report, 1997, p. 5)

In the context of these different perceptions of the concept of the company in the continental European/Japanese and Anglo-American model, the *Interim Report's* justification for the privileging of shareholders in the corporate governance system is thus a clear reference to the argumentation evident in the Anglo-American model. This argumentation is, however, embedded in a context where the company is initially defined as a community of stakeholders, which is a reference to the traditional Japanese system of corporate governance. It is reasonable to interpret the tension in argumentation here between the two opposites of the European (Continental)/Japanese model of corporate governance and the Anglo-American model as reflecting a tension between the different values and cultures inherent in the two models. Indeed, the *Interim Report* refers to a competition between these two models of corporate governance evident in the globalised market:

The globalized market: A competitive arena for two systems

- the Euro-Japanese vs. Anglo-American model
- system of seeking profits for 'pluralistic-oriented' constituencies vs. system of seeking profits for "individualistic-oriented" shareholders: (Interim Report, 1997, p. 5)

In 1997, when the *Interim Re*port was published, there seems to have been a perception amongst members of the *Japan Corporate Governance Forum* that both governance systems were competing with each other. There is no reference in the above statement, however, to the situation whereby as a result of that competition one model might gain supremacy in the global market. With hindsight, one may suggest that the 'competitive arena' the *Interim Repor*t was referring to was more of a battlefield to establish the supremacy of one of the two governance systems. It will thus be interesting to see if and how the various versions of *The Corporate Governance Principles* of the forum reflect the increasing global influence of the Anglo-American system (*subter*).

Having established the position of shareholders as the key motivation for introducing corporate governance systems, the *Interim Repo*rt considers who would be best placed to oversee and guarantee the functioning of a proper corporate governance mechanism: 'In publicly-owned corporations, the board of directors is the most effective vehicle of corporate governance' (Interim Report, 1997, p. 2). The *Interim Report* stresses that, from a Japanese perspective, the board of directors has a key role to play in corporate governance:

> ...corporate governance by definition rests with the conduct of the board of directors, who are chosen on behalf of the shareholders. The directors are entitled to govern the company, and to supervise and monitor the company's management in order to promote effective management and ensure prudent accountability to the shareholders. The board of directors therefore is the primary overseer in the company, monitoring management to ensure that it is a) always endeavouring to maximize corporate value in the long term for the shareholders, and b) always prepared to be accountable for its actions to all the stakeholders and – in particular – to shareholders. (Interim Report, 1997, p. 2)

The key role that the board of directors plays in the corporate governance model in the *Interim Report* again reflects UK/US debates. Much of the work on corporate governance by policy makers as well as academics has argued that the board of directors has been key to the success or failure of corporate governance mechanisms (Bonn et al., 2004). Failures of the board of directors to monitor and effectively control management's operations have been linked to corporate failures with significant negative global socio-economic implications. Committees set up in the UK and US to investigate the effectiveness of prevalent corporate governance systems have thus consistently come up with proposals for the improvement of corporate governance that put an emphasis on strengthening and reforming the role of the board of directors. Relatedly, legislation has also provided a framework to support any changes in the composition and duties and responsibilities of the board of directors (Clarke, 2007, 139-144; Monks and Minow, 2008, pp. 223-228). Again, reflecting UK/US debate, the *Interim Report* offers a critique of the functioning of the board of directors of Japanese companies in practice:

> It is a fact, however, that in practice the role of the board of directors and that of the management executives has not always been defined. Furthermore, the board of directors has not necessarily been equipped with

> sufficient governance authority and capabilities (Interim Report, 1997, p. 3).

The problem lies in the particular role prescribed for the board of directors within the dual structure of the conventional Japanese governance model. The board of directors 'carries out the functions of strategic decision-making' whereas the board of corporate auditors 'audits management's execution of business activities'. The problem identified here was that although the board of directors concerns itself with strategic decision-making, it 'does not have real decision-making power'. According to the *Interim Report* (ibid., p. 5):

> ...decisions tend to be actually taken by the "management board", or by the "management board of directors".

A further problem of the Japanese corporate governance system that the *Interim Report* referred to was the composition of the board of directors:

> Indeed, most members of the board of directors are "executive" directors (inside the company) and therefore are often "employees" of the company. In this situation the realization of meaningful governance is difficult. (ibid., p. 6)

A concern about the composition of the board of directors and the lack of its independence from the company management has been variously addressed in debates in practice and by research in especially the Anglo-American context (see, for example, Ahmadjian, 2003; Clarke, 2007). Many proposals for changes in corporate governance mechanisms have indeed suggested that an effective corporate governance system can only be established if the independence of members of the board of directors is significantly improved (Solomons, 2007).

Having elaborated a critique of the operations of the Japanese board of directors, the *Interim Report* attempted to improve the role of the Japanese board of directors through issuing a specific corporate governance principle. This principle aimed to strengthen and clearly define the role and function of the board of directors:

> The corporate governance principle described herewith proposes that the governance powers of the board of directors be firmly established, thereby guaranteeing both the effective management and prudent accountability the company needs to survive in the globalised market place (Interim Report, 1997, p. 3).

Suggestions were made as to how such an effective board of directors could be achieved:

> The function of the board of directors should be rejuvenated to i) cope with the more complicated global market; and ii) to be honest advisors for management, which could be trapped with a dilemma whereby stronger managers could become more complacent. (Interim Report, 1997, p. 6)

The *Interim Report* stressed the important role of the board of directors especially in a context where 'the market mechanism does not function perfectly due to market failure and to administrative regulations' (Interim Report, 1997, p. 3). In this context, the *Interim Report* suggested that the board of directors had to take on an important role in monitoring management:

> ...the board of directors' governance takes on even a social responsibility: through their duty of supervising management's actions, the directors are

> contributing towards the transparency of the market (Interim Report, 1997, p. 3).

The recognition that an imperfect market necessitates governance echoes the argumentation of the general debate on corporate governance concerning the need for information disclosure and transparency (Solomon, 2007). This concern about transparency thus also underpins the corporate governance principles of the *Interim Report*.

Another key issue addressed in the *Interim Report* is profit maximisation by shareholders. It is of interest here to look in more detail at how profit maximisation by shareholders is defined:

> Profit-seeking conduct by shareholders means that they expect to maximise residual profits after other stakeholders have already been given a fair share of the profits according to the market mechanism. (Interim Report, 1997, p. 3)

The above definition of shareholders' profit-seeking reflects the European (Continental)/Japanese model of corporate governance with its emphasis on 'the concept of the company as community' (Interim Report, p. 5). The model works with a notion of profit-seeking, which according to the *Interim Report*, is in a dichotomous relation to the notion of profit-seeking in the Anglo-American model of corporate governance. The two systems are:

> ...[a] system of seeking profits for "pluralistic-oriented" constituencies vs. [a] system of seeking profits for "individualistic-oriented" shareholders. (Interim Report, 1997, p.5)

Indeed, it was this tension between the different profit-orientations of the Japanese and the Anglo-American corporate governance models that the *Interim Report* had identified as one of the 'Problems to be Solved' in its attempt to provide a blueprint of governance for Japanese companies (Interim Report, 1997, p. 5). The following quote indicates the tensions between the community orientation of the Japanese firm and the shareholder orientation of the Anglo-American firm:

> ...the role of management is to strive to maximize shareholders' profit, while simultaneously coordinating the appropriate profit level for other stakeholders in the market. (Interim Report, 1997, p.3)

Further, the *Interim Report* stressed the important role of employees in the context of shareholder wealth maximisation:

> Without duly stable cooperation between employees and management, shareholders' value as such will never be maximized. (Interim Report, 1997, p. 4)

In recognition of the need to secure the cooperation of employees, Japanese companies have devised various schemes aimed at profit-sharing:

> To achieve smoother and more effective co-operation, Japanese companies have introduced...devices such as "bonus system" and "stock-holding plans", which basically share profits with employees (Interim Report, 1997, p. 4)

All the various schemes are aimed at the following:

> The goal of these systems is to achieve compatibility between maximizing shareholders profits, and maximizing the profit "pie" for all stakeholders (Interim Report, 1997, p. 4).

The above attempts to emphasise shareholders as the major beneficiaries of the wealth created by the company and at the same time also refer to the need to get employees on board reflect the broader community oriented culture in Japan, which is in stark contrast to the emphasis that is placed in UK/US society on the individual. The latter concern is epitomised in Margaret Thatcher's view that there was no such thing as society – only individuals and families. This tension is further evident when the *Interim Report* aims to explicate the roles of management and the board of directors. Management has to 'strive to maximize shareholders' profit, while simultaneously coordinating the appropriate profit level for other stakeholders in the market' (Interim Report, 1997, p. 3), and, similarly, the board of directors 'functions[s] simultaneously as the shareholders' delegates and as the promoters of the benefits of all concerned stakeholders' (Interim Report, 1997, p. 4).

The emphasis in Japan on employees and their interests and wellbeing is reflected in the practice of "life-long employment". The *Interim Report* identifies this practice as one that contrasts with the kind of employment practices that are typical of the UK/US context. Life-long employment is a feature of the Japanese system that according to the *Interim Report* should not be changed:

> The Japanese model does not allow hasty labor restructuring. This model should be preserved. Economic ineffectiveness should be corrected not by terminating employees, but instead by redeploying them in the wider interests of society. (Interim Report, 1997, p. 5)

Such a stance is clearly diametrically opposite to especially UK/US HR practices, which put a high value on restructuring and down-sizing in their attempts to address inefficiencies and to cut costs (Jacoby, 2005). How strong this Japanese notion of employment relations is becomes evident in the following statement in the *Interim Report*:

> Labor adjustment can represent an easy transfer of business risks to employees, a practice that violates the basic ethics of capitalism and the Japanese notion of corporate governance. (Interim Report, 1997, p. 5)

The reference to the ethics of capitalism points to the particular understanding of capitalism that is characteristic of the Japanese context (Dore, 2000).

The last characteristic of the Japanese system that the *Interim Report* draws attention to is 'the unique feature of the Japanese *shachō* (president), in the context of the *shachō's* style of corporate governance' (Interim Report, 1997, p. 3). The role of the *shachō* is described as follows:

> The Japanese *shacho* is the CEO, and often the chairperson of the board of directors. As the leader of his or her company, an effective *shacho* is hard working, spirited, reliable, level headed, has good communication skills and a comprehensive grasp of...where the company is headed in the future. (Interim Report, 1997, p. 3)

And:

> All these qualities, however, are insufficient unless he or she is a person of responsibility, firmly determined to maximise long-term corporate value. (Interim Report, 1997, p. 3)

According to the *Interim Report*:

> The legitimacy of the *shacho* is really derived from and recognized only by his or her sense dedication to be fully responsible to the shareholders, whose desire is the maximization of shareholder value. (Interim Report, 1997, p. 4)

Interestingly, this statement shows how the *Interim Report* sought to establish the legitimacy of a Japanese characteristic of corporate governance by linking it to the UK/US notion of shareholder wealth maximisation. This strategy is evident throughout the *Interim Report*. Indeed, the report, after having outlined the important issues that need to be addressed in the Japanese corporate governance debate and having drawn attention to important characteristics of the Japanese system of corporate governance, then goes on to outline principles of corporate governance so as 'to present a Japanese model of corporate governance' (Interim Report, 1997, p. 4). These principles reflect UK/US practice in especially emphasising the role of shareholders and the board of directors in their corporate governance model for Japan but this is done in a context in which the board of directors functions 'simultaneously as the shareholders' delegates and as the promoters of the benefits of all concerned stakeholders' (Interim Report, 1997, p, 4). Below it is shown how the tension between Japanese characteristics of corporate governance and UK/US characteristics of corporate governance is reflected in the *Corporate Governance Principles* that the *Interim Report* prescribes.

8.2.1.2. The Proposed *Corporate Governance Principles*

The *Interim Report* lists its proposed corporate governance principles under the following two main headings: (i) Accountability and Disclosure, and, (ii) Governance Structure. Under these two headings, issues concerning shareholders and issues concerning the board of directors are discussed respectively. It is of interest here that the *Interim Report* offers a brief definition of two kinds of disclosure that have to be considered in the context of a general concern about accountability and disclosure: an '"offer of information" within a closed loop of immediate directors and shareholders', and, '"information disclosure"' to 'outside parties, or "constituencies"' (Interim Report, 1997, p. 7). It is reasonable to suggest that this particular way of categorising provision of information reflects the particular Japanese context in which a close relationship between certain large shareholders traditionally exists. The report stressed that these two types of information although different in the sense defined above 'are usually treated as identical' (Interim Report, 1997, p. 7) but held:

> ...the fundamental difference between the two types of information certainly exists. Therefore the "information offer to the shareholders"...and a general "information disclosure to the stakeholders" should be recognized as two different concepts. (Interim Report, 1997, p. 7)

Given this distinction in terms of different types of information provision, Principle 2A also stated that there should be different forms of information disclosure to shareholders other than the formal business reports. Such disclosure, it ws stated, was particularly important in the context of events that might impact upon the particular interests of shareholders (Interim Report, 1997, p. 7). Further, reflecting the concern of being successful in the global market place, Principle 3A stated that prevalent/current regulations should always 'be swiftly adjusted to new global accounting rules' (Interim Report, 1997, p. 7). Global accounting rules, which can also be read as the rules set by the *International Accounting Standards Board (IASB),* were here - as was the case in the context of the bi-lateral trade negotiations between Japan and the U.S. - not seen as a controversial issue.

The board of directors' responsibility to coordinate the various interests of all other shareholders manifests itself in Principle 4A, which requires directors to 'undertake wider disclosure of company information for the benefit of non-shareholder stakeholders' (Interim Report, 1997, p. 8).

In proposing principles for the governance structure of Japanese corporations, the following areas are addressed in the *Interim Report*: directors and the board of directors; auditors and the board of corporate auditors; shareholders' meetings (Interim Report, 1997, pp. 9-10). The suggestions made in these principles were all aimed at separating the functions of the board of directors from that of the executive board. Particular emphasis was placed in this context on non-executive directors. Following the UK/US model, it was proposed that 'non-executive directors should comprise a majority on the board'. It was also proposed that a committee structure of the board of directors be implemented and legislated for:

> Within the board of directors, several committees should be established, such as those for designating directors, setting directors' remuneration, business auditing etc...Remuneration of the *shacho* and other "representative" directors is to be decided only by non-executive directors. (Interim Report, 1997, p. 9)

Principle 10B dealt with characteristics of the Japanese corporate structure, which had been especially subjected to critique: namely that in many traditional Japanese companies there was no separation between governance and business execution:

> The chairperson of the board of directors – as the highest responsible member of the governance structure – and the chairperson of the board of executives - as the highest responsible officer of business execution – are not to be the same person (Interim Report, 1997, p. 9).

Reflecting the Japanese context at the time, however, Principle 10B also suggested:

> When the combination of the two functions is necessary, an explanation should be offered to the shareholders (Interim Report, 1997, p. 9).

In terms of auditors, it was proposed that the independence of auditors should be strengthened through abolishing the 'five year rule, by which a virtually inside officer could be designated as an auditor after five years of absence from the company or related company' (Interim Report, 1997, p. 10).

Shareholders' meetings were also to be improved, especially through enhancing the dialogue between shareholders and the board of directors. It was further suggested that 'separately from the shareholders' meeting, information meetings for major shareholders may be held for more detailed discussions' (Interim Report, 1997, p. 10). This principle was a response to criticism that had been variously made of the practice of Japanese companies to generally hold shareholder meetings at the same time.

The above analysis of the *Corporate Governance Pri*nciples of the *Interim Report* has shown how a self-regulatory body attempted to respond to pressures to change the conventional Japanese corporate governance system. Of particular interest here is that the *Interim Report* reflects the tensions between a particular local corporate governance structure and the globally promoted Anglo-American model. The proposals made for changes in the corporate governance system of Japan incorporate features of the Anglo-American model. There appears to be, however, a concern to argue that certain characteristics of the local Japanese system are equivalent to characteristics of the Anglo-American system or that they can be modified and built upon in such a way as to resemble characteristic features of the Anglo-American system. Pointing to the tensions and contradictions in the *Interim Report,* Jacoby (2007, p. 8) made the following comment: 'The document is a marvel of diplomacy.' It is of note, that the way in which the *Interim Report* aimed to find a way of change, which would allow valued Japanese particularities to remain whilst also introducing some Anglo-American characteristics into the system, more generally reflects a particular stance to change evident in Japan at the time. Inagami (2001, p. 229), for example, in this respect quotes *Nikkeiren's* view that the main thrust of corporate governance reform in Japan should be 'not to negate everything Japanese, but instead to preserve those basic features of

Japanese-style management which are laudable, such as its consideration for human beings and its long-term outlook, while modifying what needs to be modified'.

The *Japan Corporate Governance Forum* is of particular interest as it constitutes an initiative by industry to set the standard for what is deemed to be good corporate governance practice. This attempt at self regulation attracted wide interest nationally as well as globally, with the *California Public Employees' Retirement System* (CalPERS) most prominently endorsing the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* as best practice for Japanese companies (Jacoby, 2007) and recommending that they 'should be adopted as a benchmark for Japanese corporations' (Suzuki, 1998, p. 33). CalPERS had been interested to introduce and strengthen the shareholder-value approach in overseas markets. One of the markets identified was Japan, which according to CalPERS:

> '…has a structure that is least like the United States. There, shareholder returns are subordinated to the growth of the company and the interest of the keiretsu and affiliated shareholders' (CalPERS, quoted in Jacoby, 2007, p. 8).

CalPERS, following a strategy of finding local partners in their attempts to change the corporate governance structures of countries they invested in, had seen an opportunity in working together with the *Japan Corporate Governance Forum* in its attempt to change Japanese corporate governance in line with the Anglo-American model. Through such an approach it was hoped that hostilities against foreign interference could be minimised. CalPERS also issued its own corporate governance principles for Japan shortly after the *Interim Report* had been published.

One significant difference between the *Interim Rep*ort and the CalPERS principles, as Jacoby (Jacoby, 2007, p. 9) has pointed out, was that CalPERS did not include any of the 'language related to stakeholder' that the analysis above has shown is evident in the *Interim Report*. The partnership between CalPERS and the Corporate Governance of Japan, however, did not materialise as the differences between the two approaches to reform were too significant (Jacoby, 2007, p. 9).

8.2.2. Corporate Governance Principles – A Japanese View (Final Report)

Seven months after the publication of the *Interim Report,* the *Corporate Governance Principles – A Japanese View (Final Report)* was published on 26 May 1998 (Final Report, 1998). Tadao Suzuki, the Chairperson of the Corporate Governance Committee, pointed to developments in Japan as well as in the global context during these seven months:

> ...developments in the business environment have been more rapid than we anticipated: the bankruptcy of Yamaichi Securities and Hokkaido Takushoku Bank, the amendment of the Foreign Exchange Control Law, and the commencement of the Japanese Big Bang have all had significant influences on the Japanese market.
>
> Turning to overseas developments during this period, in April the OECD...published its report entitled Corporate Governance: improving competitiveness and access to capital in global market, whilst in March the Hampel Committee in the UK published its corporate governance report. Also in March, CalPERS...published its own Principles of Corporate Governance for Japan (Suzuki, 1998, p. 33).

There are some interesting differences between the *Interim Rep*ort and the *Final Repor*t, which reflect developments referred to above and the feedback received on the *Interim Report.* The feedback received was from within Japan as well as from outside of Japan, especially from the U.S. Respondents included academics, corporate auditors, lawyers, accountants, analysts and CEOs (Final Report, pp. 58-59). More generally, there is a stronger and clearer emphasis on shareholders and their interests and a playing down of stakeholders and their interests. The tension that was evident in the *Interim Report* between accommodating shareholders and stakeholders in the corporate governance principles has thus been reduced. Already on the first page of the introduction the duty of managers is clearly spelled out:

> ...managers ought to be responsible for the long term maximization of shareholders' profit and should exercise fiduciary duty towards shareholders (Final Report, 1998, p. 36).

It is of note that the *Interim Report* only referred to shareholders' profit (Interim Report, 1997, p. 2) but did not mention 'maximization' of shareholders' profit. There is further reference to maximisation of shareholder value and in contrast to the *Interim Report*, again without reference to stakeholders in the following quote in the context of a concern about the motivation of the board of directors:

> Thus the motivation of board of directors is a prime concern; the key importance of shareholders within the corporation, and the goal of a going concern as being the maximization of shareholders' long-term value, need to be clearly understood and strongly shared amongst all of the company's participants (Final Report, 198, p. 42).

A similar shift away from stakeholders is also evident in relation to a component of the Japanese corporate system, namely, Japanese employment practices. In relation to labour restructuring, the *Interim Report* noted:

> The Japanese model does not allow hasty labor restructuring. This model should be preserved (Interim Report, 1997, p. 5)

The last sentence of the above quote did not appear anymore in the *Final Report* although there was still an emphasis on the value of the Japanese practice to 're-allocate employees to newly created profitable sectors' (Final Report, p. 41). Interestingly, the *Final Report* still links such practices to an 'irresponsible transfer of business risks to employees' and suggests:

> It is common Japanese management practice to subscribe to such ethical principles of personnel management, and we believe this notion could add certain values to the Anglo-American model of corporate governance (ibid.).

Further, there is more explicit reference to U.S. practices, for example, 'executive committees' (ibid. p. 42) and the proposed structure for the board of directors reflects the Anglo-American version. Similarly, the principles covering disclosure now more directly refer to developments internationally:

> The board of directors should begin to report globally consolidated semi-annual accounts based on the mark to market accounting system as soon as the "international standard" now under consideration is finalized. Quarterly reporting of accounts should also be introduced as soon as possible (Final Report, 1998, p. 45)

In summary, the *Corporate Governance Principles* of the *Final Report* indicate a further move away from the conventional Japanese corporate governance and corporate system towards to Anglo-American corporate governance and corporate system. They now clearly specify the objective of the firm as shareholder value maximisation and propose an Anglo-American style of board of directors with various committees, including an Audit Committee, a reduction in the size of the board of directors and an increase in the number of independent Directors. In terms of disclosure the need to adopt international standards is further emphasised.

8.2.3. Kaitei Koporeito Gabanansu Gensoku (Revised Corporate Governance Principles)

Since the publication of the *Corporate Governance Principles* in 1998, important changes in the context had taken place, which necessitated a revision of the Principles. According to Yoshihiko Miyauchi (2001, p. 33)[113]:

> Since that time [i.e. publication of the Principles in 1998], however, there have been a multitude of further changes, including a greater understanding of corporate governance in Japan, the introduction of executive officers to separate the functions of corporate boards and day-to-day management, new trends in the revision of the Commercial Code, and greater exercising of voting rights by institutional investors. In short, Japanese companies as well as the environment in which they operate have undergone a dramatic transformation.

In 2001 a revised set of principles, the *Revised Corporate Governance Principles*,[114] was issued to reflect the above changes in the context, including global pressure on Japan to adopt a US style corporate governance model. Miyauchi (2001, p. 33) pointed out that the Committee had held meetings between 1998 and 2001 'in order to keep abreast of these developments' and that '[t]hese new Principles are part of a forward-thinking movement to improve Japanese

[113] He was the Chairperson of the Japan Corporate Governance Committee responsible for the revision of the principles in 2001.
[114] The *Revised Corporate Governance Principles* are I the following referred to as *Revised Principles*.

corporate policy' and that they 'are the result of earnest and vigorous debate between the practical and academic sides of this topic'.

The *Revised Principles* further embraced aspects of the Anglo-American Corporate Governance system. The most significant move in this direction was the abolishment of two principles, which referred to the Japanese system of corporate auditors and the board of corporate auditors. The Japanese board of corporate auditors is independent of the Japanese board of directors and has a monitoring function. The independence of the corporate auditors has been a key feature of critique. In response to this criticism, the *Interim Report* as well as the *Final Report* had made proposals as to how the independence and effectiveness of the board of corporate auditors could be strengthened. Such suggestions were contained in Principle 11A and Principle 12A. Both principles as well as the section entitled 'Corporate Auditors and the board of corporate auditors' (Final Report, p. 51) were not included in the *Revised Principles*. Principle 13A, which recommended the establishment of an Audit Committee within the board of directors and which had previously been included in the section on corporate auditor was, however, incorporated into the *Revised Principles*. By only including the Anglo-American style board of directors in its *Revised Principles* the *Japan Corporate Governance Forum* abolished a key feature of the conventional Japanese corporate system, namely the monitoring role of the board of corporate auditors.

The *Revised Principles* in general provide more detail on the various issues that should be taken into account in the context of setting up a good corporate governance system. An area, where this detail is significant is that of 'Accountability and Disclosure' (Final Report, 1998, p. 45). The *Final Report* stated:

> It is the responsibility of the board of directors to oversee the company's entire information network in particular the shareholder relation mechanism (*ibid.*).

In the *Revised Principles* the more general reference to the 'company's entire information network' was replaced by the introduction of a Principle concerned with 'internal control' (*Revised Principles*, 2001, pp. 65-66) and another concerned with disclosure (ibid, pp. 67-68). The emphasis on internal control again reflects concerns of the Anglo-American debate on corporate governance, especially in the context of corporate collapses (Clarke, 2007, p. 62).

In summary, the *Revised Principles* constitute a further move away from the conventional Japanese corporate governance system and the Japanese corporate system. The *Revised Principles* cover the typical areas of the Anglo-American corporate system, namely, mission and role of the board of directors, mission and role of the committees established within the board of directors, leadership responsibility of the CEO addressing shareholder derivative litigation, securing fairness and transparency for executive management, reporting to the shareholders and communicating with investors (*Revised Principles*, 2001, p. 35).

8.2.4. Shin Koporeito Gabanansu Gensoku (New Corporate Governance Principles)

In December 2006, *New Corporate Governance Principles* were approved and subsequently published in March 2007. In the message from the Chairperson Professor Ochiai stated that after the publication of *Kaitei Koporeito Gabanansu Gensoku* (*Revised Corporate Governance Principles*) there have been many developments domestically as well as globally. In Japan, for instance, the amendment of the *Commercial Code* in 2002 has enabled Japanese companies to choose either the traditional Japanese style corporate governance system with a *Board of Auditors* (consisting of a majority of outside auditors) or the Anglo-American style corporate governance system with an *Audit Committee*. Furthermore, the *Company Act* had been standardised by combining laws related to company regulation in May 2006. In addition, there has been a growing concern about *Corporate Social Responsibility (CSR)* and a rise of hostile takeovers as a business control approach. In the global context, mainly the U.S., there had been recurrent corporate scandals such as, for example, *Enron*, *World.Com*, which led to the introduction of the legislation of the Sarbanes-Oxley Act (*Shin Koporeito Gabanansu Gensoku,* 2001).

The Chairperson pointed out that despite the amendment of the *Commercial Code*, only a small number of Japanese companies had moved to the Anglo-American style of corporate governance with its Audit Committee. In light of these developments, the *Japan Corporate Governance Forum* had thus decided to publish new corporate governance principles, which also considered those companies that had chosen the traditional Japanese style of corporate governance with its board of corporate auditors. The Chairperson pointed out, however, that the basic philosophy had remained the same as in the *Revised Principles*.

The *New Principles* are of particular interest as they specifically refer in their recommendations to both types of companies, those with an Audit Committee and those with a board of corporate auditors. For the case of companies with a board of corporate auditors, for example, the Principles suggest that they should also establish committees such a remuneration or nomination committees and that these committees should consist of at least three members, the majority of which should be non-executive directors (*New Principles*, 8). Reflecting contextual developments, the *New Principles* thus constitute a hybrid corporate governance system that aims to incorporate components of the conventional Japanese corporate governance system in a system, which is basically the Anglo-American model of corporate governance. The *Corporate Governance Forum* had to adopt this position of compromise if it wanted its *Corporate Governance Principles* to be acceptable to Japanese companies.

The *New Principles* also added some new areas that were now deemed to be relevant because of contextual developments. These areas included corporate social responsibility, accounting audit[115] (or external audit), hostile takeovers and the role of employees in establishing an appropriate corporate governance system..

8.3. SUMMARY DISCUSSION

The analysis of the four versions of the *Corporate Governance Principles* that the *Japan Corporate Governance Forum* published during the period from 1998 to 2006 has highlighted how, through global pressure, local corporate governance rules and regulations were questioned and how attempts were made to align the local and national regulations with what was perceived good practice globally. The analysis has shown that, in the process of such alignments, tensions can arise with what are perceived to be valued particularities of the local, i.e. in the case here the Japanese system of corporate governance. Developments of the corporate governance principles, which were initially outlined in the *Interim Report* of 1997, indicate how, through increasing pressure in the global market place, Japanese characteristics more and more were either modified or diminished and were replaced by characteristics of the Anglo-American corporate governance system. Local characteristics of the Japanese corporate governance system were challenged and threatened by powerful Western institutions to conform to what was perceived to be good corporate governance practice from a Western perspective. The changes in the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* highlight this Western influence and a shift towards a corporate governance

[115] "Accounting audit" is the Japanese term for external audit, that is, an audit carried out by a CPA.

with strong Anglo-American elements. As a consequence, valued local corporate governance characteristics were displaced. In the Japanese case, it can be argued, that it is the emphasis on community and a duty of care, which is under threat by a global move towards individualism and a reliance on market forces. In light of the global move towards the Anglo-American corporate governance it is of particular interest that the *Japan Corporate Governance Forum* felt that it had to step back from prescribing principles that embraced the Anglo-American type of corporate governance. Especially with the amendment of the *Commercial Code*, which allowed companies to choose their respective corporate governance system, it had become untenable to uphold the Anglo-American corporate governance system as "best" practice. In the *New Principles* both types of corporate governance – the Japanese and the Anglo-American – are included. On the face of it this step constitutes a going back to the positions taken in the *Interim Report* and the *Final Report*. A comparison of the way in which Japanese and Anglo-American characteristics interrelate in the different versions of the Principles indicates, however, a significant difference between the *Interim Principles* and the *Final Report* on the one hand and the *New Principles* on the other. In the *Interim Report* and the *Final Report* a clear tension between the values underpinning the Japanese and the Anglo-American corporate governance model was evident and there appeared to be a struggle over supremacy of one of the systems. In contrast, in the *New Principles* aspects of the Japanese corporate governance system were integrated into the Anglo-American framework of corporate governance. It can be argued that the *New Principles* thus constitute a hybrid system. Interestingly, although there is still an emphasis on the Anglo-American model in the *New Principles,* capture has not been complete. The next chapter, chapter 9, offers concluding comments, makes some suggestions for a way forward of Japanese corporate governance and highlights areas for future research.

CHAPTER 9

CONCLUDING COMMENTS AND WAYS FORWARD

Chapter nine summarises the insights gained from the analysis. It considers the threats to and opportunities for the Japanese corporate governance system emanating from the global pressure to change and to adopt a corporate governance system that is underpinned by different cultural values. The chapter is also concerned to consider manifest and potential consequences on the well-being of the people living in Japan emanating from changes to the Japanese corporate governance system and the Japanese corporate system. And, the chapter offers suggestions for possible ways forward for Japanese corporate governance in the global context. It also points to the need for the West to critically reflect upon its own practices and begin to question and challenge the taken-for-granted supremacy of the Anglo-American model of corporate governance. The chapter concludes by arguing that a global corporate governance system, which is concerned with well-being globally, needs to take into account the global as well as the particular and points to further areas of research.

The study here employed a critical theoretical perspective in the analysis of debates over Japanese corporate governance. Corporate governance was understood as an embedded practice and through historical and contextual analysis the aim was to appreciate the local characteristics of the Japanese context and its interrelationship with the wider global context. The understanding of corporate governance here thus goes beyond a focus solely on the relationship between ownership and management in isolation of their prevalent context. Such a position echoes Abe's (2004, p. 1) view that although the separation of ownership and management is 'a fundamental base of economic institutions in all advanced capitalistic societies' the form this relationship takes differs between countries. It is precisely because of these differences that corporate governance needs to be analysed as embedded in its prevalent socio-economic, political, cultural and historical context. As Abe (2004, p. 1) has argued:

> In addition it is not enough to consider only the relation between shareholders and management, for the role of employees, suppliers, customers, banks, or, in other words, stakeholders is also important. By extension, state policy, laws, economic environment, culture and historical background affect the character of corporate governance as specified by the relationship between numerous stakeholders.

Informed by the above theoretical considerations, the study offered an analysis of two empirical sites, the bi-lateral trade negotiations between the U.S. and Japan during the period from 1989 to 2007 and the *Japan Corporate Governance Forum's* attempt during the period from 1998 to 2006 to arrive at a set of corporate governance principles for Japanese companies that would constitute "good practice". In order to embed these two case studies in the broader Japanese public debate over corporate governance the following two analyses were carried out: first, an analysis of the reporting on corporate governance of Japanese newspapers during the period from 1989 to 2007; and, second, an analysis of the positions taken in relation to corporate governance by key Japanese constituencies, which were directly affected by changes in the corporate system. Through a content analysis of a sample of general and financial Japanese newspapers, trends and issues in the corporate governance reporting of these newspapers were identified. The analysis highlighted three key periods in the reporting: first period, from 1996 to 1998 with the peak in the reporting in 1997; second period, from 2001 to 2004 with the peak in the reporting in 2003; and, third period, from 2004 to 2006 with the peak in the reporting in 2005. Until 1996 the reporting on corporate governance was not very significant. The three key issues of concern as evident in the sample newspapers were: board of directors, audit (including the Japanese board of corporate auditors) and disclosure.

The content analysis also indicated a major influence of developments in the U.S. and the U.S. corporate governance system on the debate, with little reference to debates taking place in the U.K. This emphasis on the U.S. was a result of the close relationship between Japan and the U.S. since the end of the *Second World War*, reflecting U.S. hegemony. In summary, the content analysis provided evidence for an emphasis in the debate over corporate governance in Japanese newspapers on the Anglo-American, especially U.S., corporate governance system and the issues of concern in debates over corporate governance from an Anglo-American perspective.

The analysis of corporate governance proposals issued by key Japanese constituencies indicated various positions and most importantly, changes in these positions during the period from 1989 to 2007. On a continuum, the views ranged from suggestions that the Japanese corporate governance system should converge with the Anglo-American model (e.g. the *Tokyo Stock Exchange*) or embrace key components of the Anglo-American model - especially the Anglo-American style board of directors with its sub-committees and disclosure requirements reflecting requirements specified by the *International Accounting Standards Board* (e.g. *Pension Fund Association*; *Japan Association of Corporate Executives, initially*) - to suggestions that the traditional Japanese corporate governance system needed to be revived (*The Japan Productivity Center*). There was also the view that Japan needed to meet a certain global standard but that at the same time it was important to improve the features of the Japanese corporate governance system (e.g. *Japanese Business Federation, Japan Association of Corporate Executives, later*). The *Japan Corporate Auditors Association*, given its own location in the traditional Japanese corporate governance system, were concerned to preserve but to improve the Japanese system. *The Japan Productivity Centre* was the strongest proponent of the Japanese corporate governance system and has during the whole period under focus here stressed the importance of life-long employment and the important role of employees in corporate governance. *The Japanese Institute of Certified Public Accountants* was at the margin of the public debate over corporate governance during most of the period focused upon here, mainly concentrating on issues related to *International Accounting Standards* and *International Financial Reporting Standards*. They only very recently set up a committee that was specifically concerned with corporate governance. The analysis has also indicated that at the earlier stages of the debates over corporate governance there was more of a concern to embrace the Anglo-American corporate governance system whereas towards the end of the period a more critical stance towards the Anglo-American corporate governance system had begun to emerge *(Japan Association of Corporate Executives)*. Further, and most significantly, aspects of traditional Japanese management practices were highlighted in a way that began to question the appropriateness of applying the Anglo-American model of corporate governance to the Japanese context. This change in view towards the end of the period under focus here can be understood to be part of a more general trend emerging in Japan since the end of Prime Minister Koizumi's term in office when politicians as well as the public had begun to critically reflect upon the liberalisation attempts from the late 1990s to 2005 and the view had emerged that liberalisation had gone too far.

The two case studies, which were understood to be embedded in the above broader public corporate governance debate of the Japanese context, provided a whole range of insights into what happened to the local Japanese corporate governance system in the context of global hegemonic pressure to change and to converge with the Anglo-American corporate governance system.

The analysis of the bi-lateral trade negotiations between the U.S. and Japan has shown how in the context of a concern on the part of the U.S. to open the Japanese market to foreign investors, especially U.S. investors, and to reduce the trade deficit between the two countries, corporate governance issues were debated. The U.S. put significant pressure on the Japanese government to change the Japanese corporate governance system to the Anglo-American corporate governance system. This change was deemed to be necessary as the Japanese corporate governance system was perceived to be lacking as compared to the Anglo-American system. It can be argued that such an attitude was Westerncentric and ethnocentric as it took as a standard for good corporate governance practices the Anglo-American model of corporate governance. It is reasonable to suggest several reasons for such a stance: first, the U.S. was concerned to make the Japanese market "safe" for foreign, and especially U.S. investors; second, U.S. hegemony globally was concerned to solidify its position through the establishment of further global standards, which in effect would be U.S. standards; third, the U.S. government, through a push for Anglo-American corporate governance, aimed to change aspects of the Japanese corporate context that were less reflective of a market mechanism. The analysis of documents issued in the context of the bilateral trade negotiations, indicated a continuous push to change the Japanese corporate governance system, with its emphasis on stakeholders - especially employees - and its rootedness in Confucian ethics, to a corporate governance model that emphasises shareholders and is based on neo-liberalism reflecting an ethics of a narrow individualism. It can be argued that changing the Japanese corporate governance system poses a serious threat to the Japanese corporate structure and the Japanese way of life. The emphasis on shareholder wealth maximisation in the Anglo-American model would significantly alter the focus of the decision-making process in Japanese companies if it was introduced in Japan. For example, the focus on short-term profit maximisation that the Anglo-American model of corporate governance encourages would entice managers to reduce the workforce in times of economic down-turn thus making the concept of long-life employment redundant. As a consequence of changes in employment practices, Japanese people's attitudes towards others would also be potentially threatened: others might no longer be perceived as part of a community one is also a member of but as competitors in a context where the individual has to fight alone for his/her survival. Such a change in attitude would clearly have a significant impact on welfare provisions and on people's well-being. Commentators within Japan on the changes proposed by the U.S. government in relation to corporate governance have pointed to such a threat to the Japanese way of life (Iha, 1991).

The analysis of the reactions of the Japanese government to the pressure from the U.S. to change its corporate governance system has indicated that especially in relation to accounting disclosure (one important component of the corporate governance system) the Japanese government had implemented most of the changes suggested by the U.S. government. In terms of corporate governance more generally, a major move towards the Anglo-American model was made when the government in the revised *Commercial Code* of 2003 introduced the option for companies to introduce the Anglo-American corporate governance model. It is interesting again to consider the reasons for this apparent willingness on the part of the Japanese government to comply with the requests of the U.S. government. One reason is possibly what Dore (2003) referred to as 'the real pressure' of trade dependency. In the context of the bursting of its bubble economy having been followed by a recession in the 1990s, the Japanese government was in a weak negotiating position. Some commentators have, however, pointed to different reasons for the willingness of the Japanese government to comply with U.S. recommendations: certain powers in Japan who wanted to further liberalise the economy were using the argument of foreign pressure to pursue their own liberalising agenda. Whatever the very particular reason or reasons for the move to introduce changes to the Japanese accounting and corporate governance system were, it remains the case that replacing the Japanese corporate governance model constitutes a threat to the Japanese way of life and to valued particularities of the Japanese system.

It is of interest to consider the way in which the Anglo-American corporate governance model was implemented into the *Commercial Code*. At first sight it appears that, with the changes in the *Commercial Code*, Japan had surrendered to the global hegemonic pressure to change its corporate governance system and to converge with the Anglo-American corporate governance system. Such a perception, however, changes, if one considers that it was optional for Japanese companies to follow the Anglo-American model of corporate governance. Commentators have variously pointed out that up-take of the Anglo-American model was low.[116] Many Japanese companies had decided to keep the traditional Japanese corporate governance system. This is an indication of a form of resistance

[116] Such a view, as the analysis of the *Corporate Governance Principles* has indicated, motivated the *Corporate Governance Forum of Japan* to amend its Principles and to include components of the Japanese corporate governance system, which had been previously excluded from the Principles.

to global hegemonic pressure. Interestingly, the U.S. administration had celebrated the changes to the *Commercial Code* as a victory. One explanation for this is that in the context of the neoliberal free-market ideology dominant in U.S. policy it was felt that market pressure would engender the desired change. From such a perspective it is not surprising that the U.S. administration saw the decision of the Japanese government to allow Japanese companies to follow either corporate governance model would have been perceived as a clear victory.

The analysis of the various versions of the *Corporate Governance Principles* of the *Japan Corporate Governance Forum* during the period from 1998 to 2006 showed that because of contextual developments the way in which the Anglo-American model of corporate governance was promoted in the *Principles* changed in a number of ways. Of particular interest to this study here was the *Interim Report*, which the *Japan Corporate Governance Forum* had published in 1998 and which was the first draft of the *Principles*. This document provides particularly interesting insights into the tensions arising where there was pressure to change the traditional Japanese corporate governance system and converge with the Anglo-American corporate governance system, which was underpinned by different cultural values. Analysis of the *Interim Report* indicated awareness on the part of the *Japan Corporate Governance Forum* of the significant differences between the traditional Japanese corporate governance system and the Anglo-American corporate governance system and a concern to find a position that would somehow, in some practical sense, reconcile both systems. It is of interest that although the *Interim*

Report promoted some of the components of the Anglo-American system, such as enhanced disclosure and the board of directors with its associated committee structure, it came out in strong support of Japanese employment practices, which significantly impact upon the Japanese way of life and people's well-being. For example, life-long employment means greater certainty and security for the employee and in the context of the Japanese community firm it reflects key aspects of Japanese culture. At the same time, the *Interim Report* was concerned to acknowledge criticism of aspects of the traditional Japanese corporate governance system and corporate system, such as, for example, the two tier board structure. The position of the *Japan Corporate Governance Forum*, however, changed and, in the *Revised Principles* of 2001, concerns to maintain aspects of the Japanese corporate governance system as well as the Japanese corporate system had been replaced by a concern to promote the Anglo-American corporate governance model. As a consequence no reference was made to the desirability of maintaining traditional Japanese employment practices. Further, the traditional Japanese board of directors and board of corporate auditors were now replaced by the Anglo-American board of directors with its associated committees, including the audit committee. This move away from the Japanese system and the embracing of the Anglo-American system took place in a context in which the Japanese government had embraced further deregulation policies and was to enhance deregulation and marketisation especially after the election of Prime Minister Koizumi in 2001. A further revision of the *Corporate Governance Principles* occurred as a reaction to change in the *Commercial Code*, which allowed Japanese companies to follow either the Japanese or the Anglo-American model. In light of this change in the law it was now unattainable for the *Japan Corporate Governance Forum* to maintain its position of promoting the Anglo-American corporate governance system as best practice. The *Japan Corporate Governance Forum* thus issued its New *Corporate Governance Principles*, which reintroduced the traditional Japanese board of corporate auditors. The way in which the Japanese board of corporate auditors was incorporated into the *New Principles* is noteworthy: the board of corporate auditors was incorporated into the framework of the Anglo-American corporate governance model. Companies were, however, encouraged to introduce an Anglo-American style board of directors with its associated committees even in a context were the company already had a traditional Japanese board of corporate auditors. This hybrid system can be understood as constituting an attempt on part of the *Japan Corporate Governance Forum* to gain support for its *Principles* from Japanese companies whilst still promoting convergence with the Anglo-American corporate governance system. A further indication of the *Japan Corporate Governance Forum's* attempt to reflect global developments in its *Principles* was the introduction of corporate social responsibility in 2006.

In summary, the two case studies and the analysis of aspects of the broader public debate on corporate governance in Japan provided insights into processes at work during the period of 1989 to 2007 when Japan had been put under global pressure to change its traditional and culturally specific corporate governance system and to converge with the culturally specific Anglo-American corporate governance system.

The analysis provided insights into how the Japanese government on the one hand because of a weaker negotiating position in relation to the U.S. and on the other, motivated by its own concerns to pursue a neoliberalist marketisation policy, accommodated requests made by the U.S. government. Further, the analysis provided insights into how various constituencies more generally and the *Japan Corporate Governance Forum* more specifically dealt with the global pressure to change. In relation to this, the study showed that what was and what was not possible in terms of corporate governance was affected by changes in the context (e.g. changes in the Japanese law). Further, the reactions of the Japanese government and the *Japan Corporate Governance Forum* constituted a threat to the traditional Japanese corporate governance system and the associated Japanese corporate system as they promoted the Anglo-American corporate governance system: through various changes to the law, and the issuance of the *Corporate Governance Principles* as an instance of good practice, the traditional Japanese corporate governance system had to begin to change. Some of the changes were compulsory, for example enhanced disclosure requirements, others were voluntary, for example the choice of board of directors.

In light of the analysis here, what are the threats and opportunities for the local including culturally specific aspects of the Japanese corporate governance system in the context of global pressure to adopt a corporate governance system underpinned by different cultural values reflecting the prevalent global hegemony? As has been explicated, the value systems underpinning the Japanese and the

Anglo-American corporate governance model are significantly different. Pressure to change the Japanese corporate governance system thus constitutes a threat to the system itself as well as the context it is embedded in and interrelates with. This would even be the case if only one component of the Japanese corporate governance system was to change as this would affect the whole system. For example, the concern to maximise shareholder wealth underpins the Anglo-American model whereas the emphasis in the Japanese model is on employees, which reflects the community orientation of Japanese culture. A shift away from an emphasis on employees to an emphasis on shareholders would also impact on the broader corporate system in which the corporate governance system is embedded. One particular aspect of the Japanese corporate system that would be affected by an emphasis on shareholders and their wealth maximisation would be Japanese employment practices, more specifically life-long employment. This would be the case because a focus on shareholder wealth maximisation would implicate employment practices such as restructuring and lay-offs during periods of poor performance, even if they are cyclical, and various forms of out-sourcing and other flexible employment practices. In such a context, life-long employment cannot be maintained. The ethos of the community firm would thus also be under threat. At the same time, there are opportunities for the Japanese corporate governance system that arise in the context of pressure to change. For example, if the number of independent members of the board of directors was to increase in line with the Anglo-American context, this could have a positive impact. It would introduce more critique and a challenging of senior management as independent directors are not, as is the case with internally promoted members of the board, morally obliged to refrain from challenging their superiors who have supported them as company employees. It is thus reasonable to argue that the particular pressure to change that the Japanese corporate governance system was exposed to during the period from 1989 to 2007 constituted threats as well as opportunities. Whether the threats or the opportunities are dominant depends on the broader context, which would affect the way in which choices can be made in terms of the components of the Japanese corporate governance system that one wishes to change. In the context of the study here, the hegemonic pressure to change coupled with the willingness of the Japanese government to embrace neoliberal reforms constituted mainly a threat to Japanese values as the choice in terms of which components of the Japanese corporate governance system to change was severely restricted.

The above considerations raise an important question: What are and will be the consequences of the implemented and proposed changes on the well-being of the people living in Japan? There is already evidence to date that the emphasis on shareholder wealth maximisation coupled with the neoliberal reforms more generally have brought about changes in the corporate system that had a negative impact on people's well-being. Japanese companies that follow the Anglo-American model of corporate governance have been involved in restructuring activities, which have left thousands of people unemployed (such as, for example, *Sony*). Such developments might become more frequent in the future, especially if the economic crises continues further. In addition, flexible employment practices have increased, which have further enhanced uncertainty and insecurity for many people. Interestingly, the Japanese public has become aware that the neoliberal reforms had an undesirable impact on people's well-being. They expressed their discontent with neoliberal policies in the latest election to the Lower House where the *Liberal Democratic Party* (LDP) who had been the ruling party from 1955 experienced a land-slide defeat.[117] This public perception is clearly a challenge for the new government. It will be of interest if there is an attempt made by the new government to change some of the neoliberalist reforms, which potentially could in turn improve people's well-being in the Japanese context.

The analysis here has focused on Japanese corporate governance in the context of global pressure to change and has explored how this pressure has already manifested in some specific changes of the traditional corporate governance system and relatedly in the Japanese corporate system. In the current global political and economic environment and complex interdependencies further change seems to be inevitable. The important question for today, therefore is not, should Japan change its corporate governance system, but, how should Japan change its corporate governance system? Below some suggestions are made for a way forward for Japanese corporate governance. It is not possible in the context of this study to provide a blueprint for Japanese corporate governance but instead an attempt is

[117] With the exception of a short period between 1993 and 1994 the LDP had uninterruptedly been in power from 1955 (Lincoln, 1999, pp. 139-140) until the last election on 30 August 2009. As a result of this election the LDP's seats in the Lower House dropped from 296 to 119 (Financial Times, 2009, p.6).

made to point to issues that need to be taken into account in the context of attempts to improve the Japanese corporate governance system.

An issue that needs to be addressed is that of convergence. As the literature review has indicated, researchers have suggested that the traditional Japanese corporate governance system is in the process of converging with the Anglo-American model and that convergence is therefore unavoidable. In contrast to this view, especially Japanese researchers writing in the Japanese language have argued that the Japanese corporate governance system should not converge with the Anglo-American corporate governance system but should be improved in a way, which is compatible with the Japanese context and Japanese culture. From a critical theoretical perspective, suggestions for a way forward for the Japanese corporate governance system would also stress the importance of valuing other cultures and aiming to preserve all those elements in systems and institutions that facilitate well-being of people and the planet.

Attempts to change the Japanese corporate governance system should be based on a thorough analysis of the positive and negative impacts that the current Japanese as well as the traditional Japanese corporate governance system have and had. These debates should take the form of a broader public discourse. In the current context it is particularly important to understand how changes to the Japanese corporate governance system have impacted upon the Japanese corporate context and their manifest and potential threats to the Japanese way of life and Japanese culture.

In attempts to arrive at proposals for change, careful consultation and engagement with those affected is vital (Gallhofer and Haslam, 2003). That means all those having a stake in the company and being variously affected by the company should be able to express their opinions. Here it is particularly important that the West – and in the context of corporate governance, especially the Anglo-American West - listens to the Japanese voice and refrains from imposing the hegemonic Anglo-American corporate governance system as the global standard.

In attempting to change the Japanese corporate governance system there has to be a recognition that Japan is embedded in a global context and that there are dependencies that are real and thus limit the way in which Japan can freely decide upon its own corporate governance system. A way forward in reducing dependencies and especially those from the global hegemonic power is to challenge the practices of the global hegemonic power. In the context of the Japanese corporate governance system this would imply forming alliances with other countries and develop critiques of the Anglo-American corporate governance system. There is clearly a general need to challenge and question the supremacy of the Anglo-American model of corporate governance.

In addition, there is a need for the West to rethink its own corporate governance systems and to critically engage with the Japanese and other non-Western corporate governance systems. Insights gained from such an engagement should then inform the redesign of Western systems. Corporate failures, redundancies on a large scale, tax avoidance and corporate fraud in the context of the Anglo-American corporate governance system are a clear indication that this model of corporate governance has its faults and should be improved (Sikka, 2004; 2005; 2008).

Researchers can make a valuable contribution to enhancing the Japanese as well as any other corporate governance systems through providing insights into and critiques of current and past corporate governance practices. In the Japanese context there is a need for more research, which explores the impact that changes to the Japanese corporate governance system had and still have on people's well-being. Further, studies are needed that explore from a critical theoretical perspective the various contributions to the corporate governance debate in Japan. And, more insights into the processes at work in shaping Japanese corporate governance are needed. In this context, studies should further explore how Buddhist thought and Shinto thought have shaped and still shape the Japanese corporate system and the Japanese corporate governance system as well as which groups and institutions within as well as outside of Japan are most influential and why in shaping Japanese corporate governance.

Finally, and most importantly, any attempts to change the Japanese corporate governance system and any research into the Japanese corporate governance system should adopt a holistic perspective and be concerned to enhance well-being. In this context it is important to also consider the impact that possible changes to the Japanese corporate governance system might have on well-being globally. The above considerations should constitute the framework within which policy debates and changes to the Japanese and other corporate governance systems are taking place.

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APPENDIX

LIST OF FIGURES

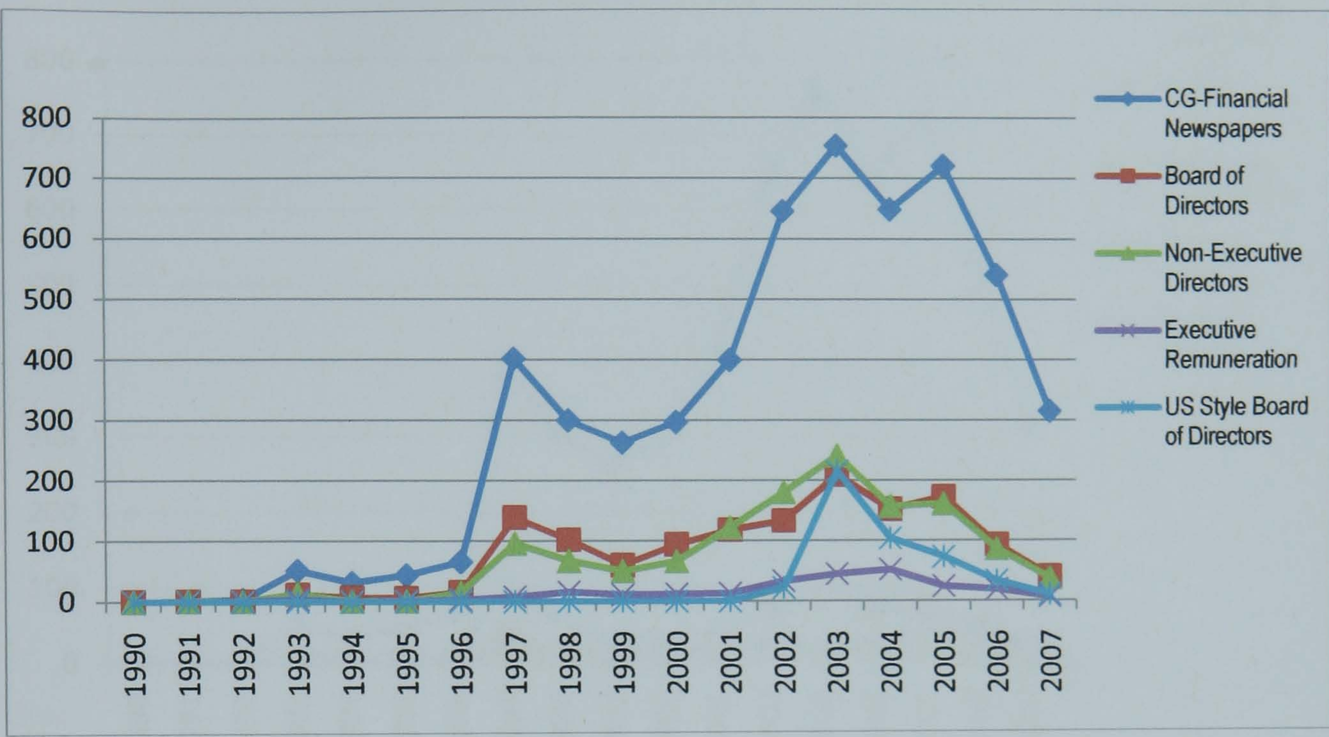


Figure 1F: Corporate Governance System (Board of Directors), Financial Newspapers

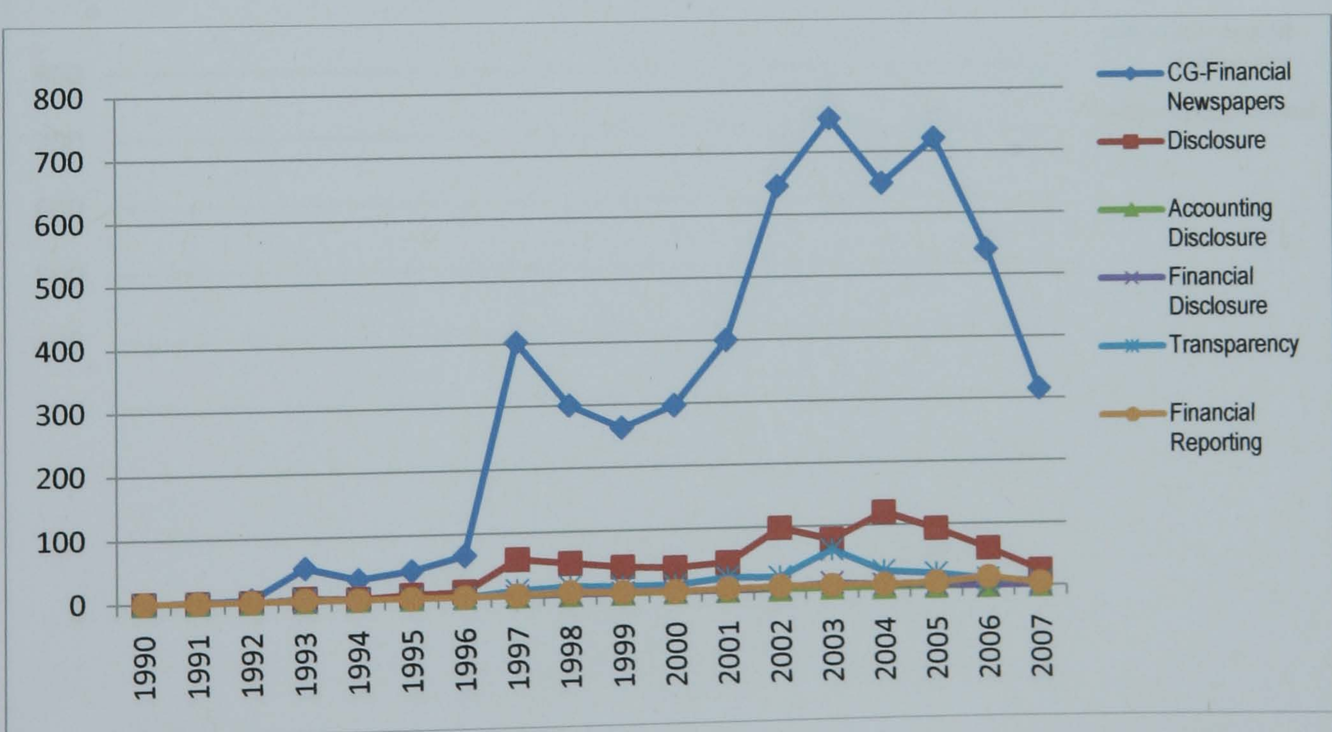


Figure 2F: Corporate Governance System (Disclosure), Financial Newspapers

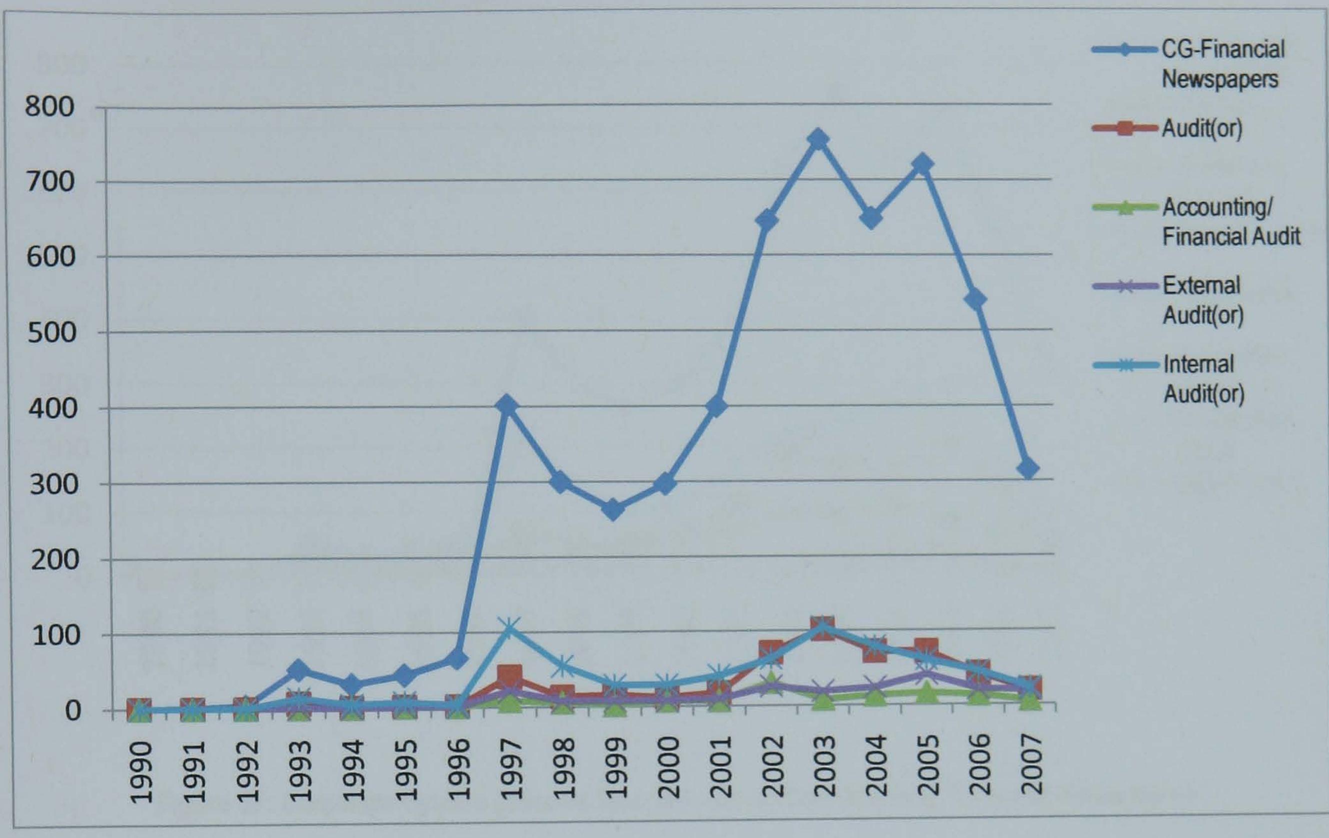


Figure 3F: Corporate Governance System (Audit), Financial Newspapers

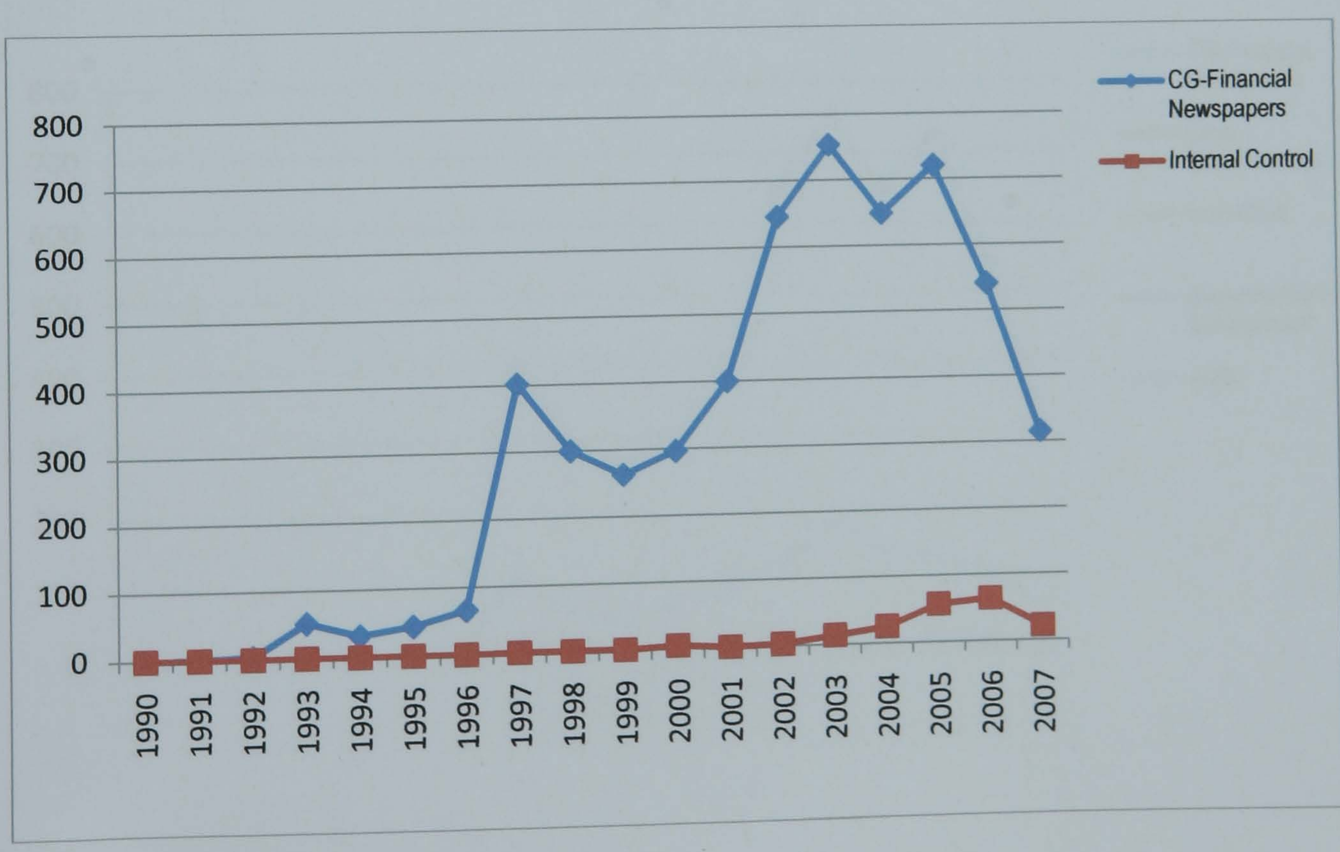


Figure 4F: Corporate Governance System (Internal Control), Financial Newspapers

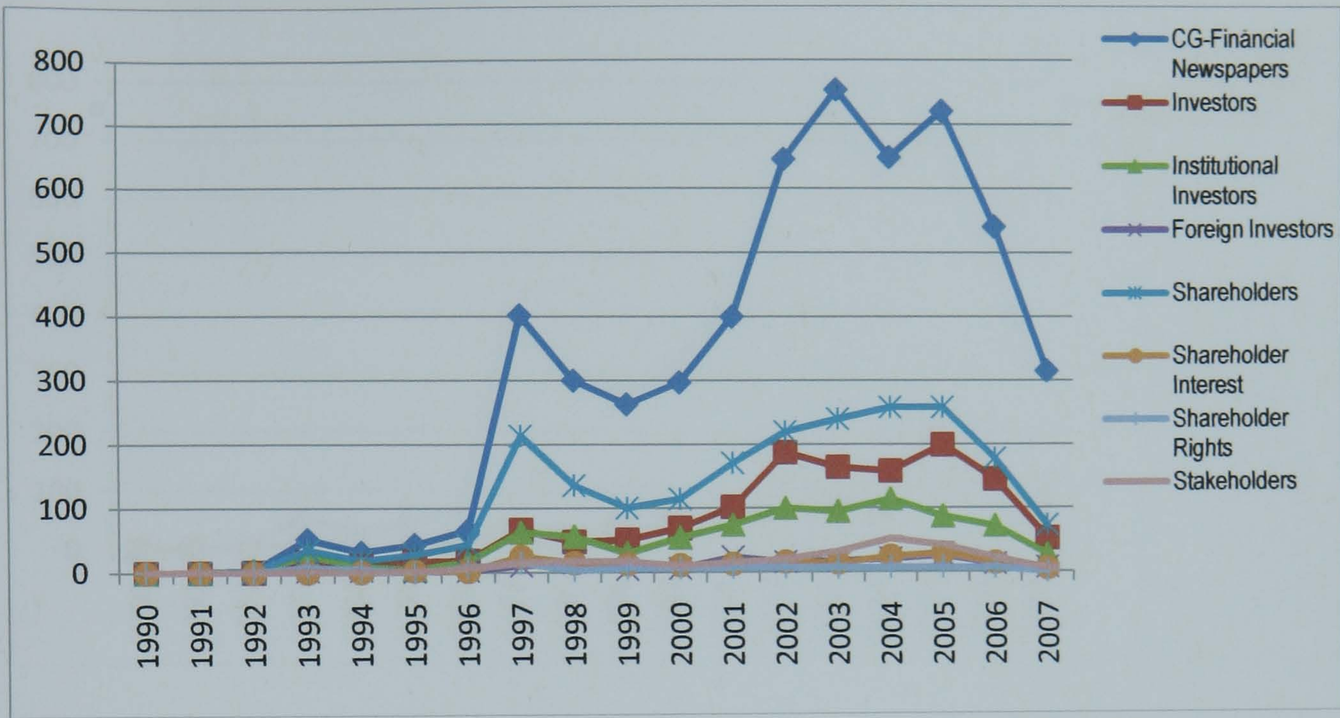


Figure 5F: Corporate System (Shareholders/Investors, Stakeholders), Financial Newspapers

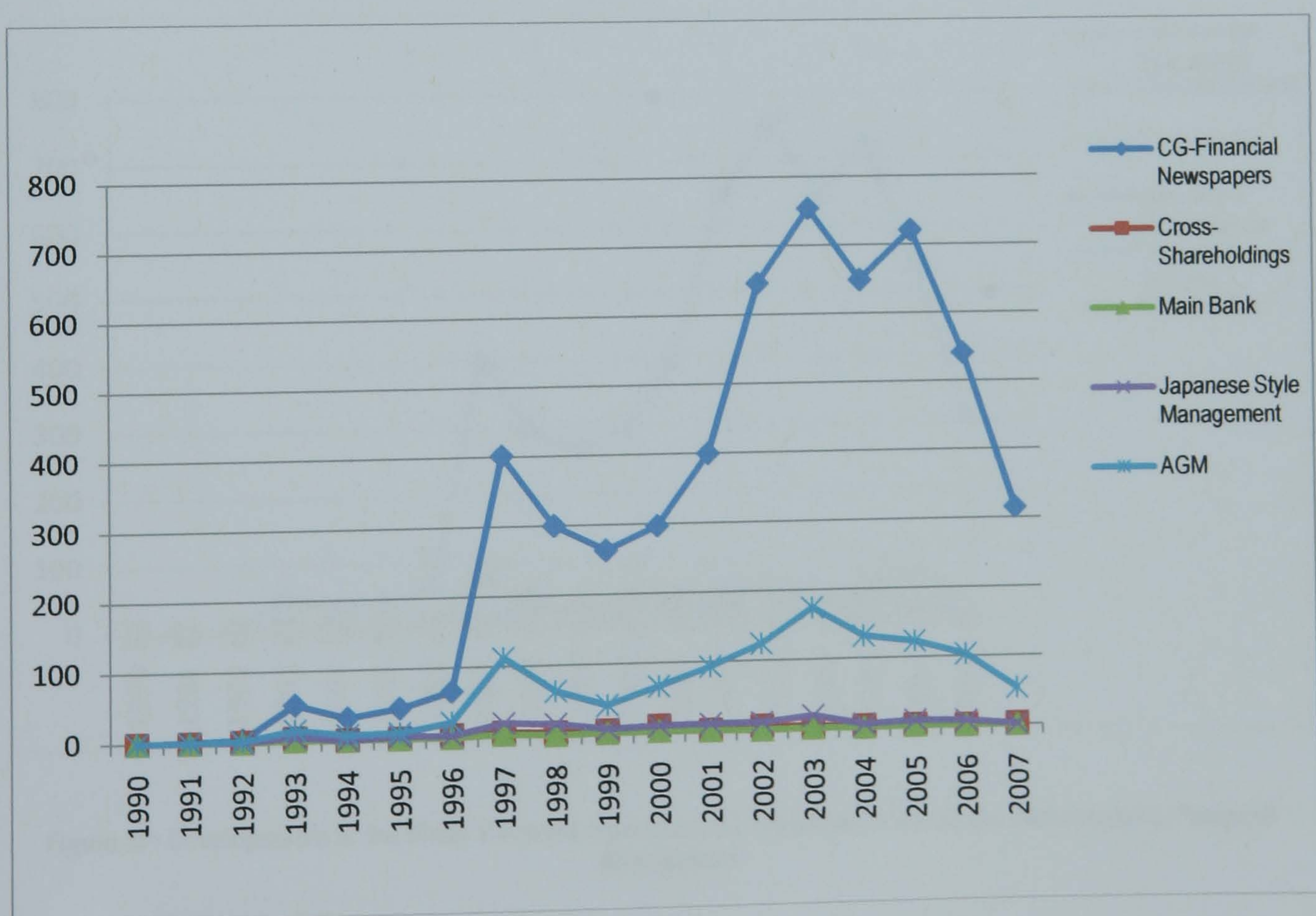


Figure 6F: Corporate System (Cross-Shareholdings, Main Bank, Japanese Style Management), Financial Newspapers

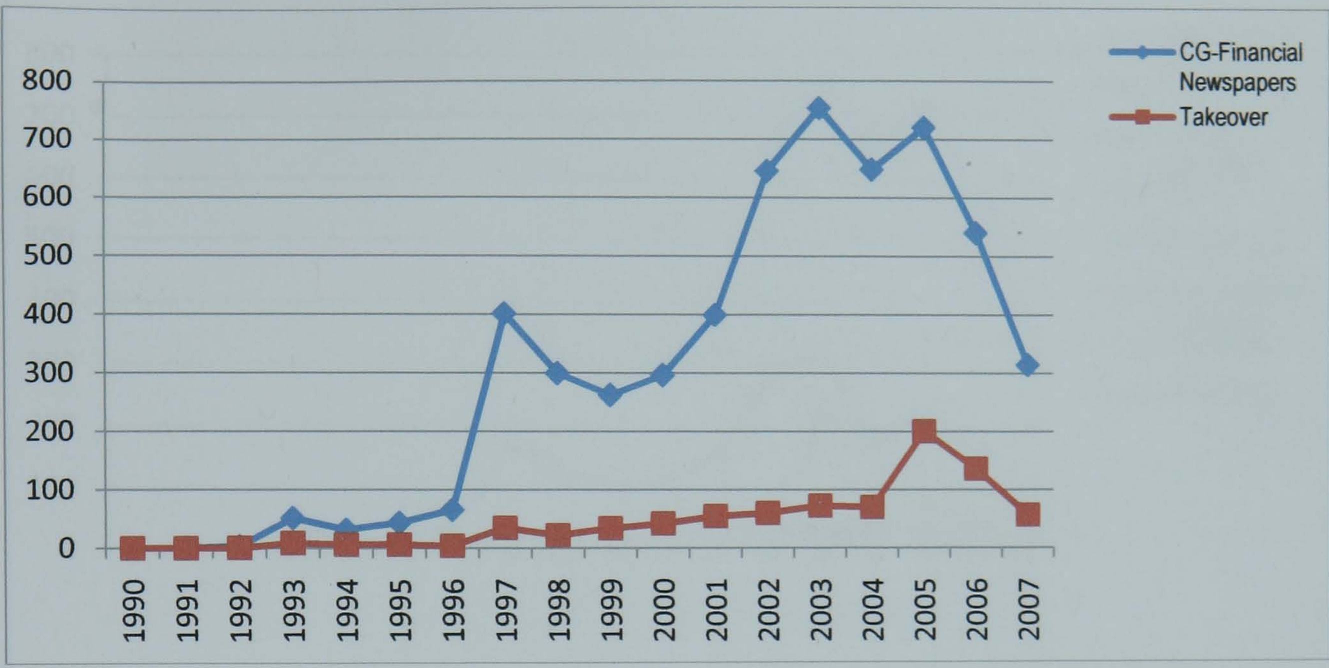


Figure 7F: Corporate Governance System (Takeover), Financial Newspapers

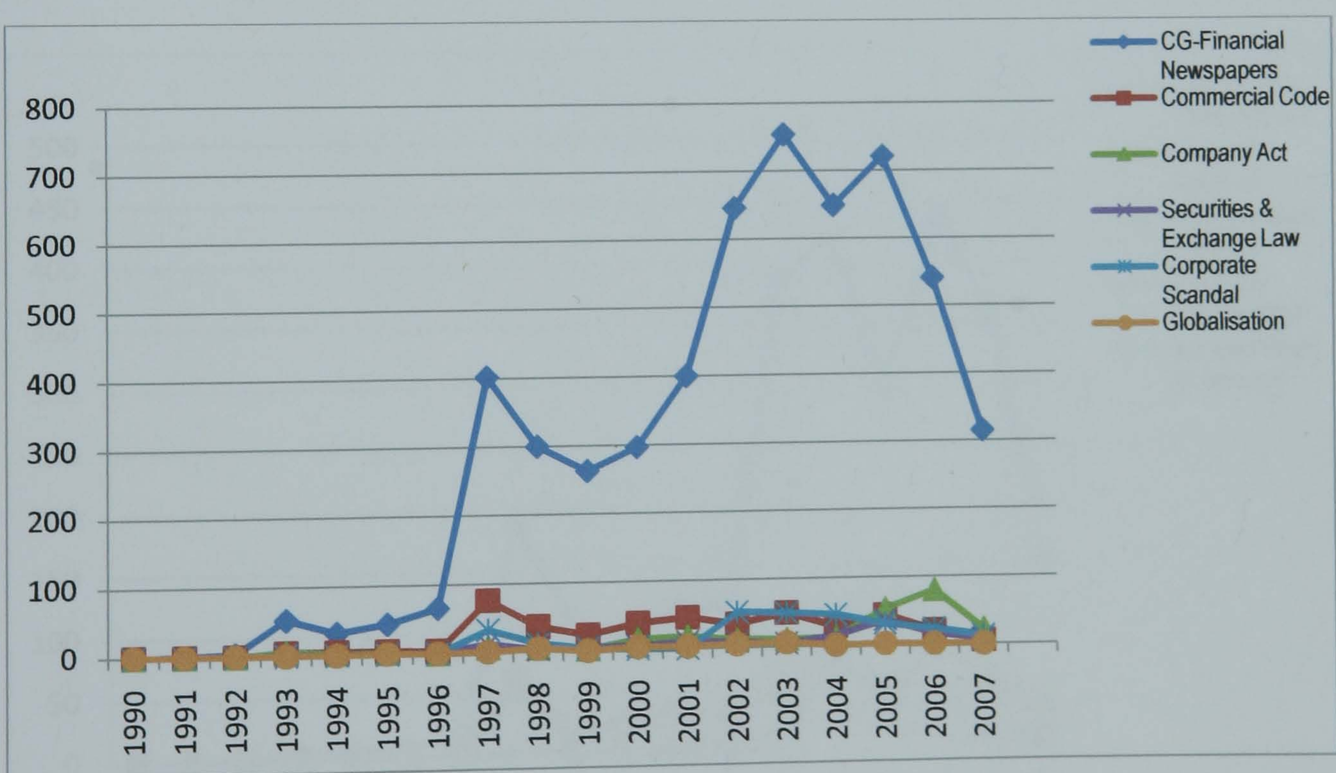


Figure 8F: Developments in the Wider Context (Japanese Law, Corporate Scandal and Globalisation), Financial Newspapers

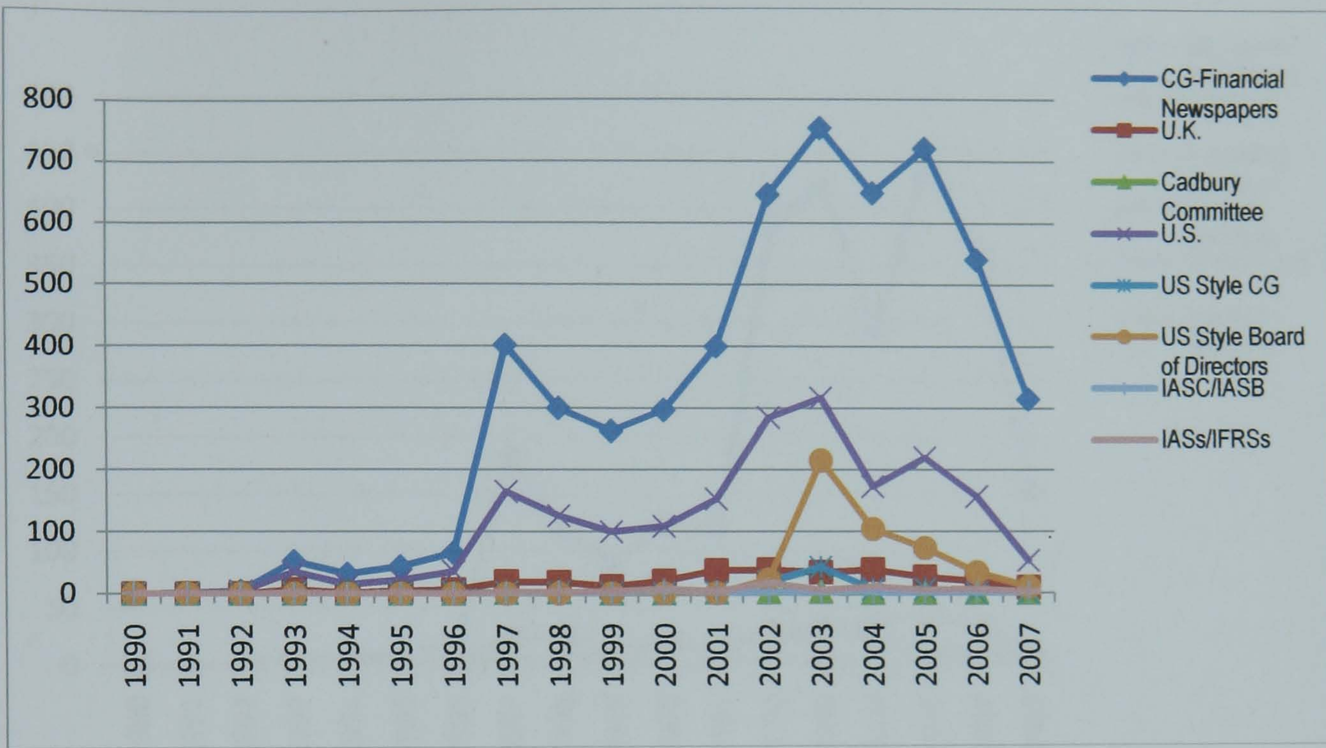


Figure 9F: Influence on Corporate Governance from Outside of Japan (U.S., U.K., IASC/IASB), Financial Newspapers

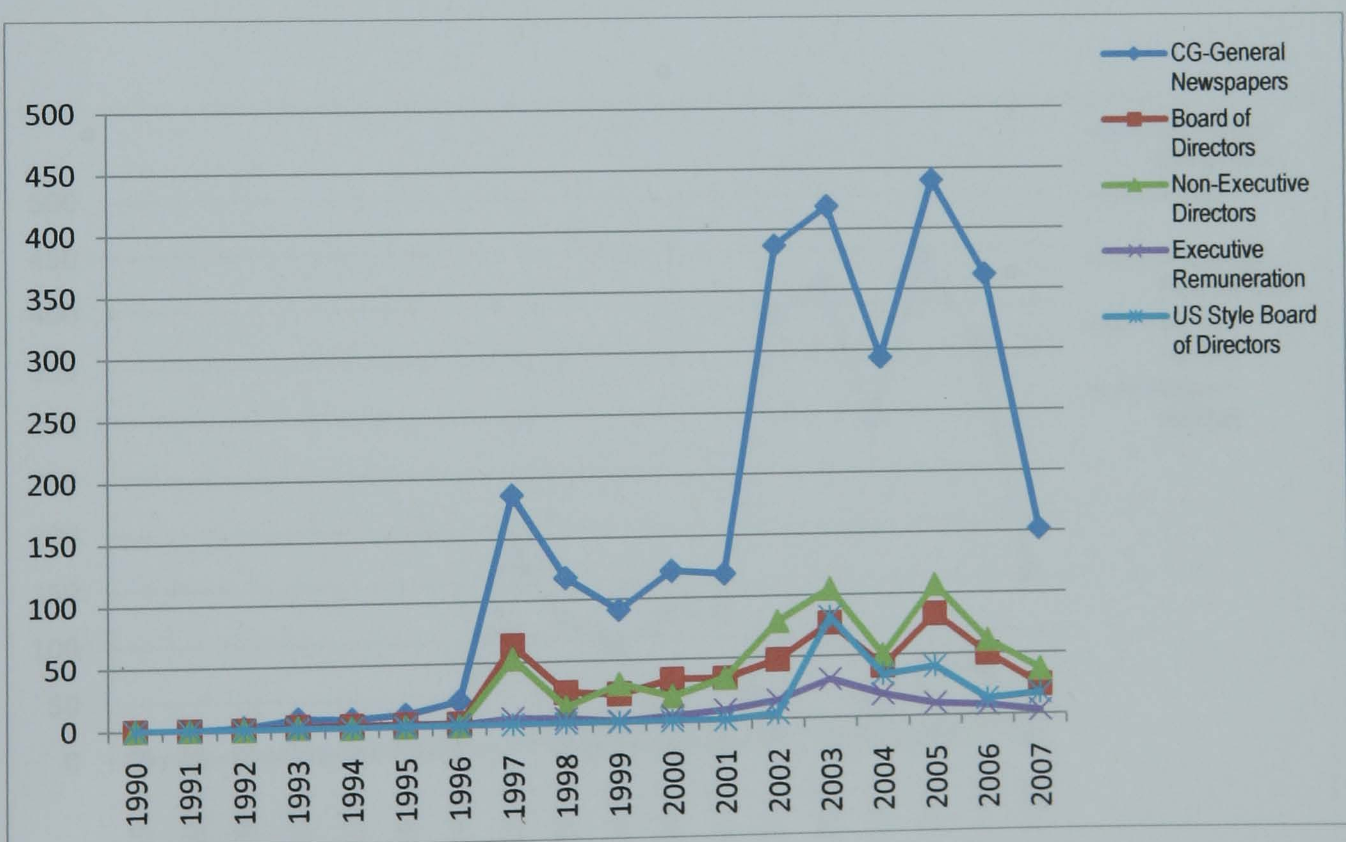


Figure 1G: Corporate Governance System (Board of Directors), General Newspapers

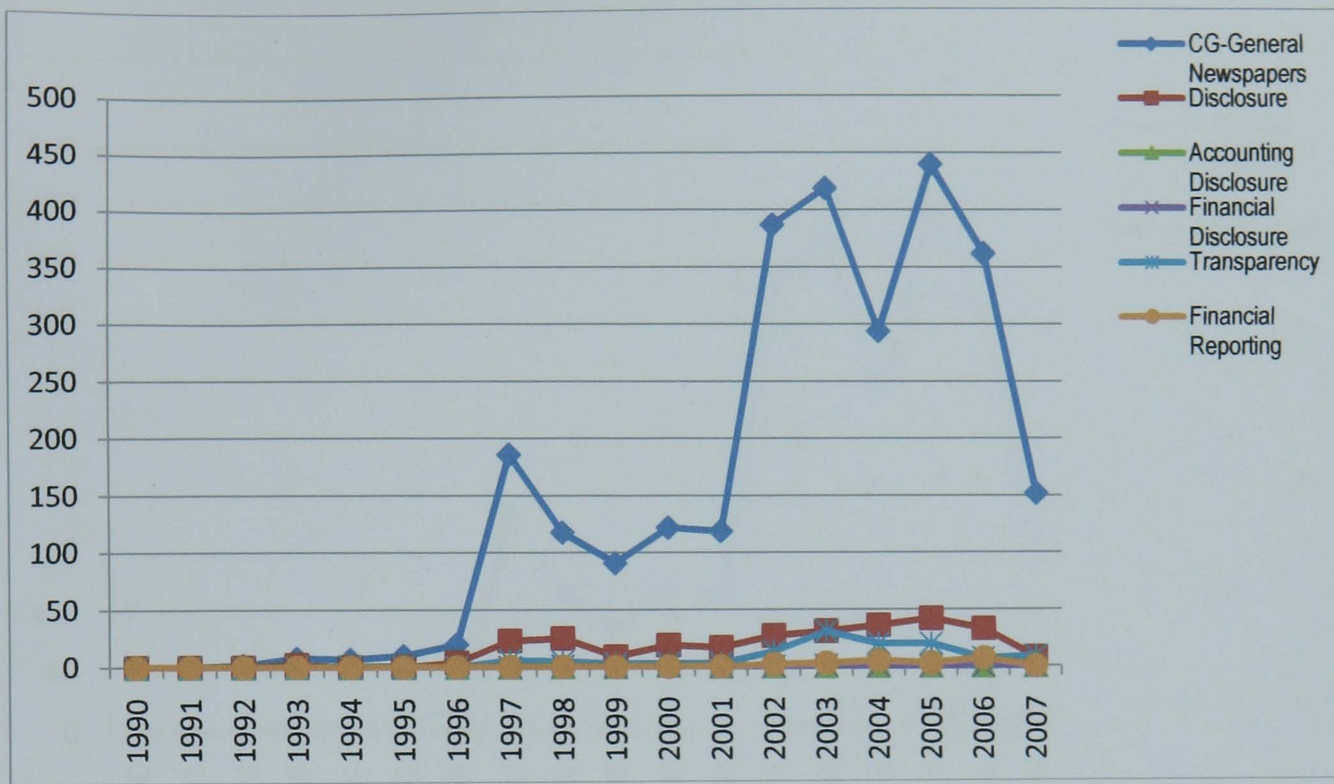


Figure 2G: Corporate Governance System (Disclosure), General Newspapers

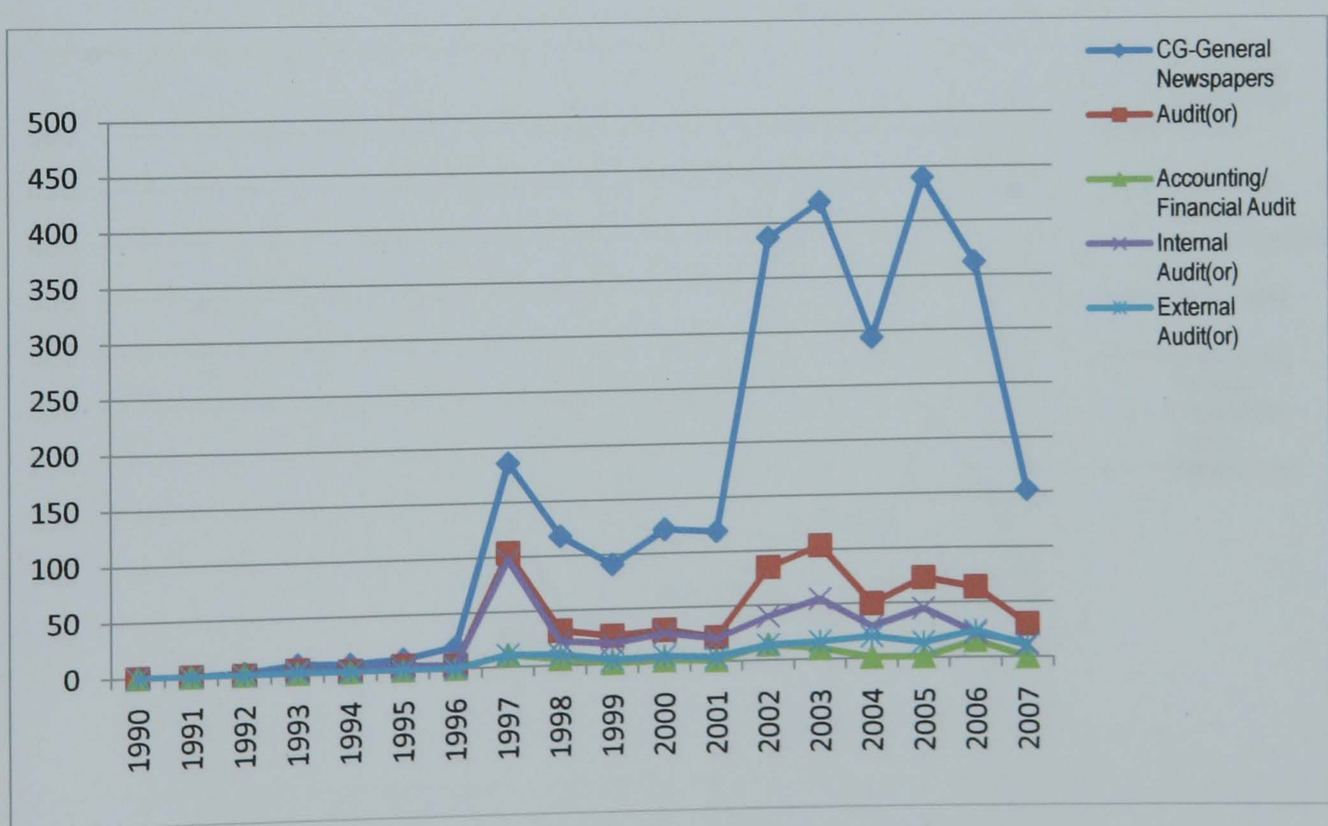


Figure 3G: Corporate Governance System (Audit), General Newspapers

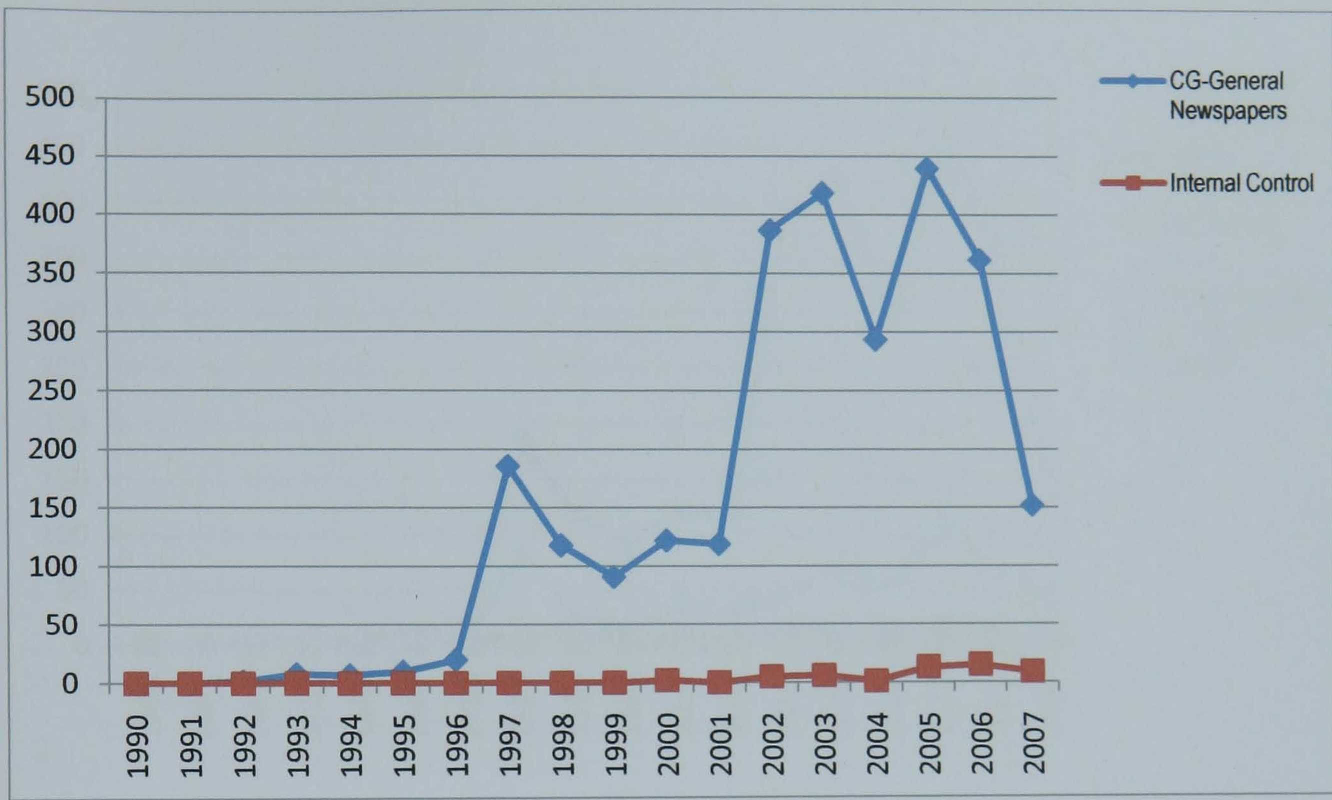


Figure 4G: Corporate Governance System (Internal Control), General Newspapers

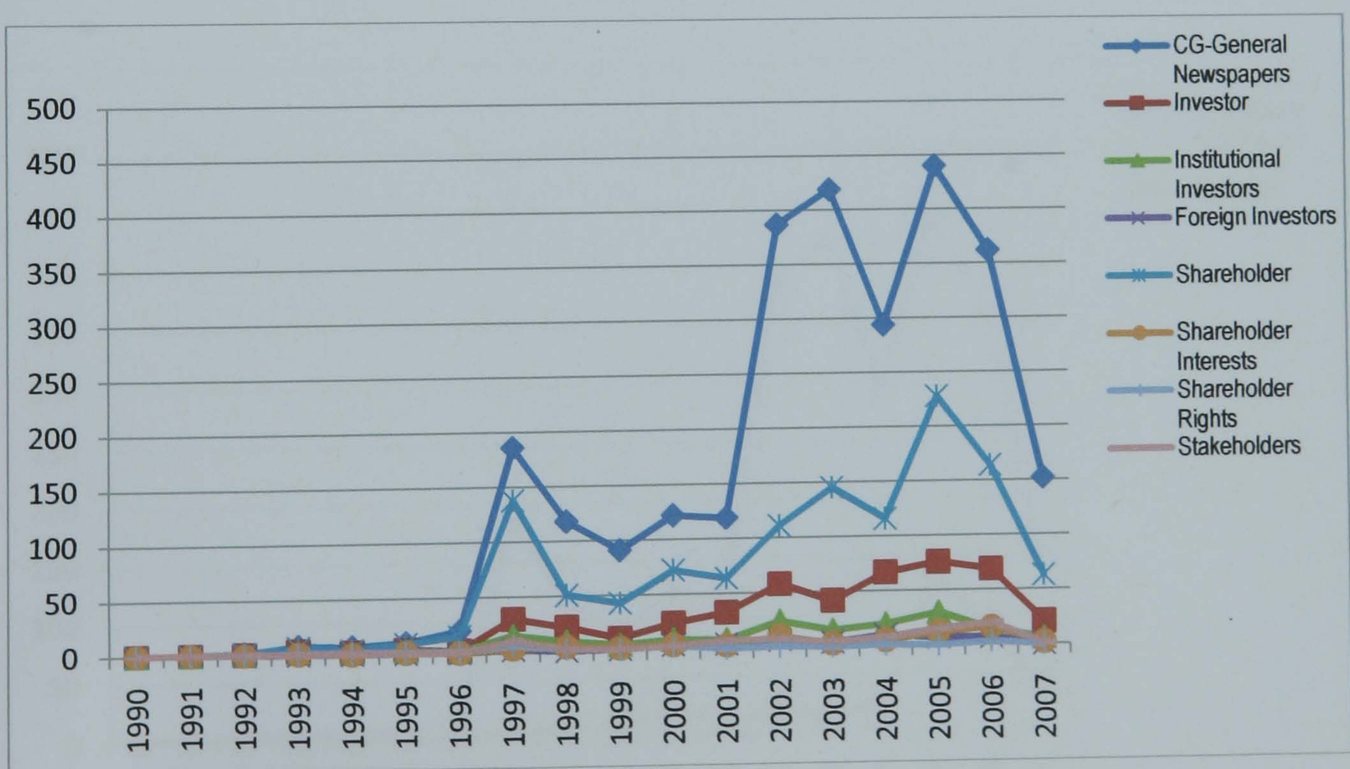
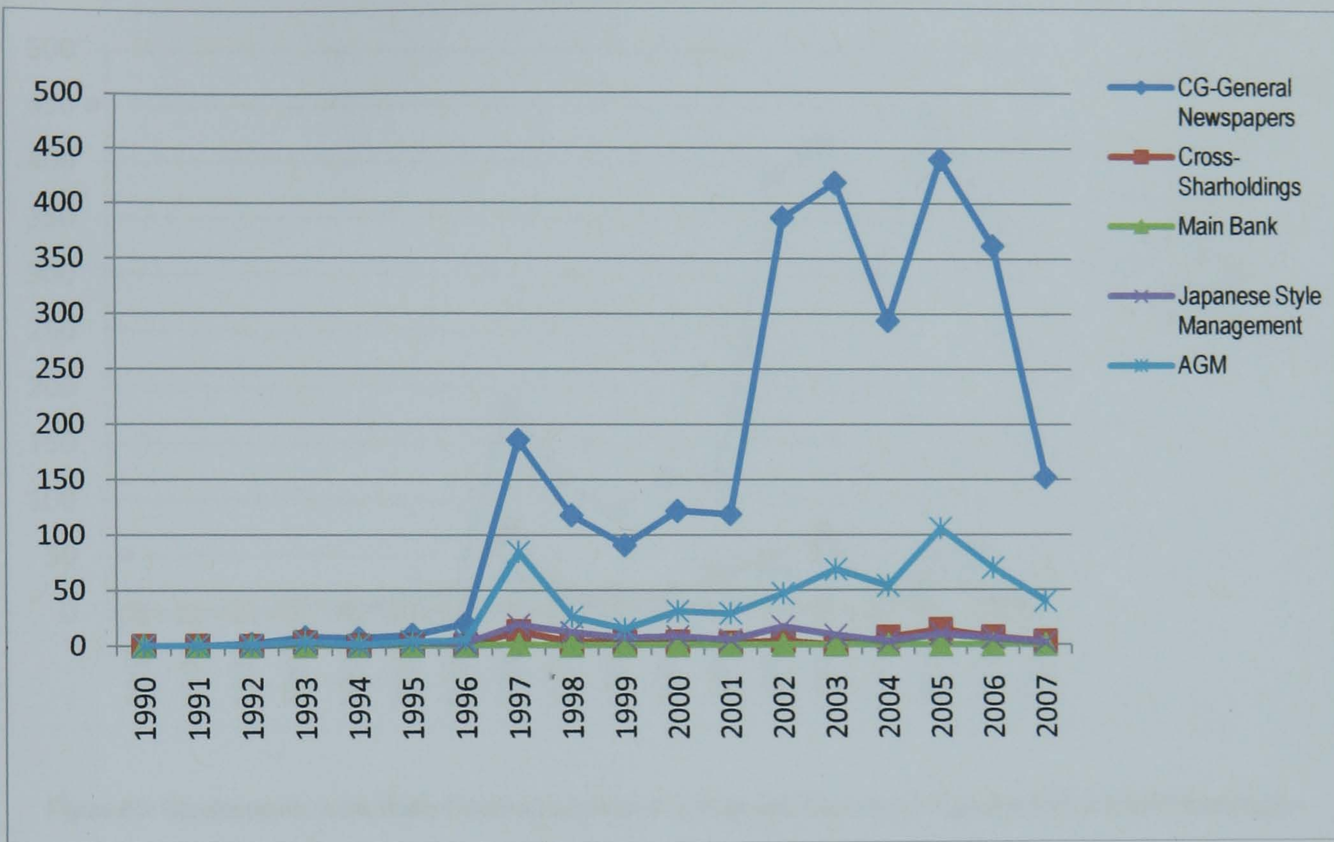


Figure 5G: Corporate System (Shareholders/Investors, Stakeholders), General Newspapers



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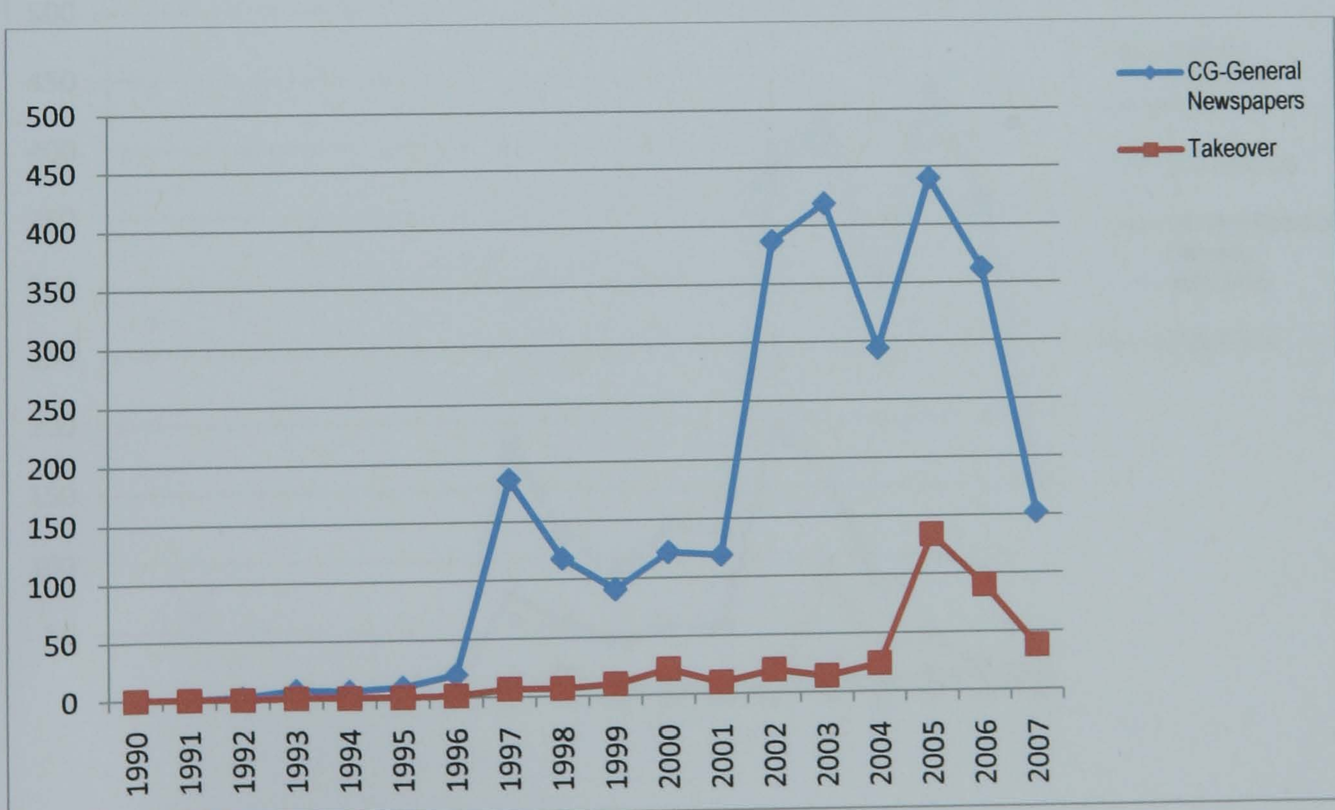

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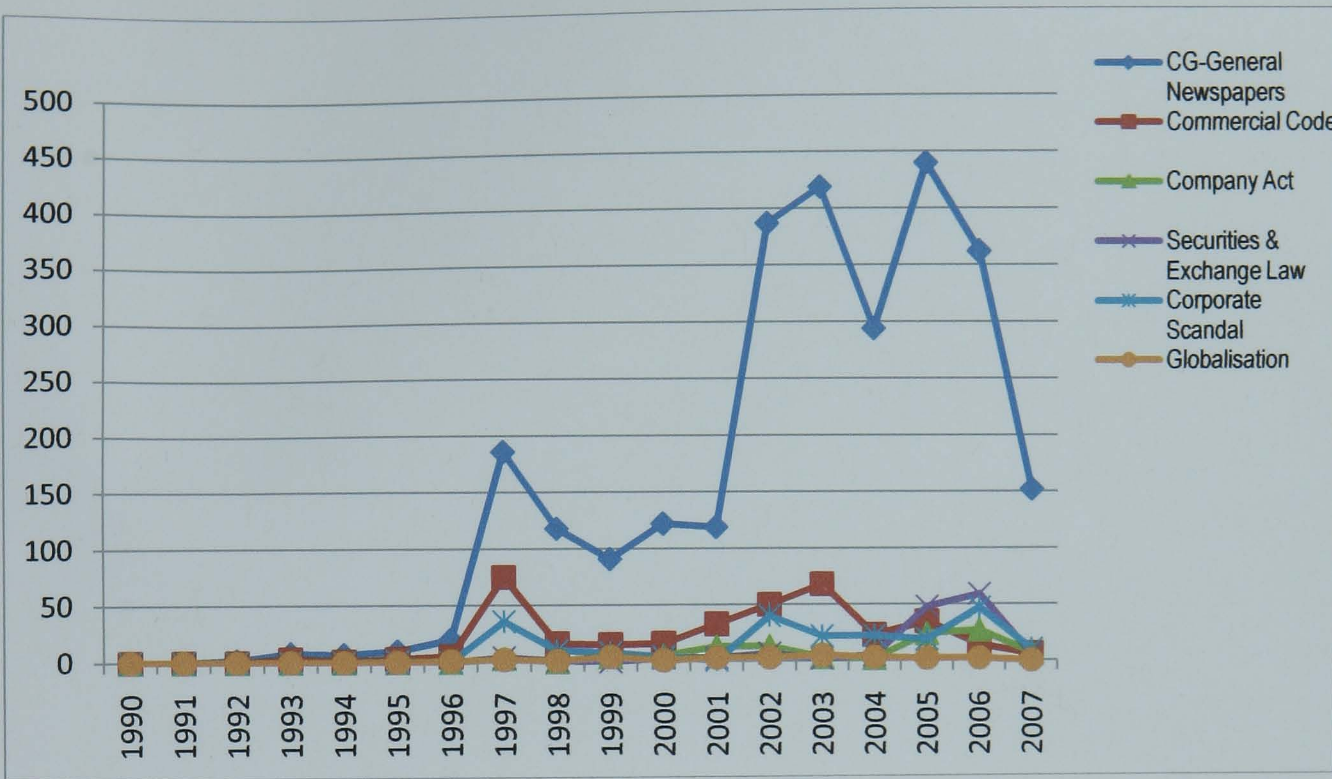

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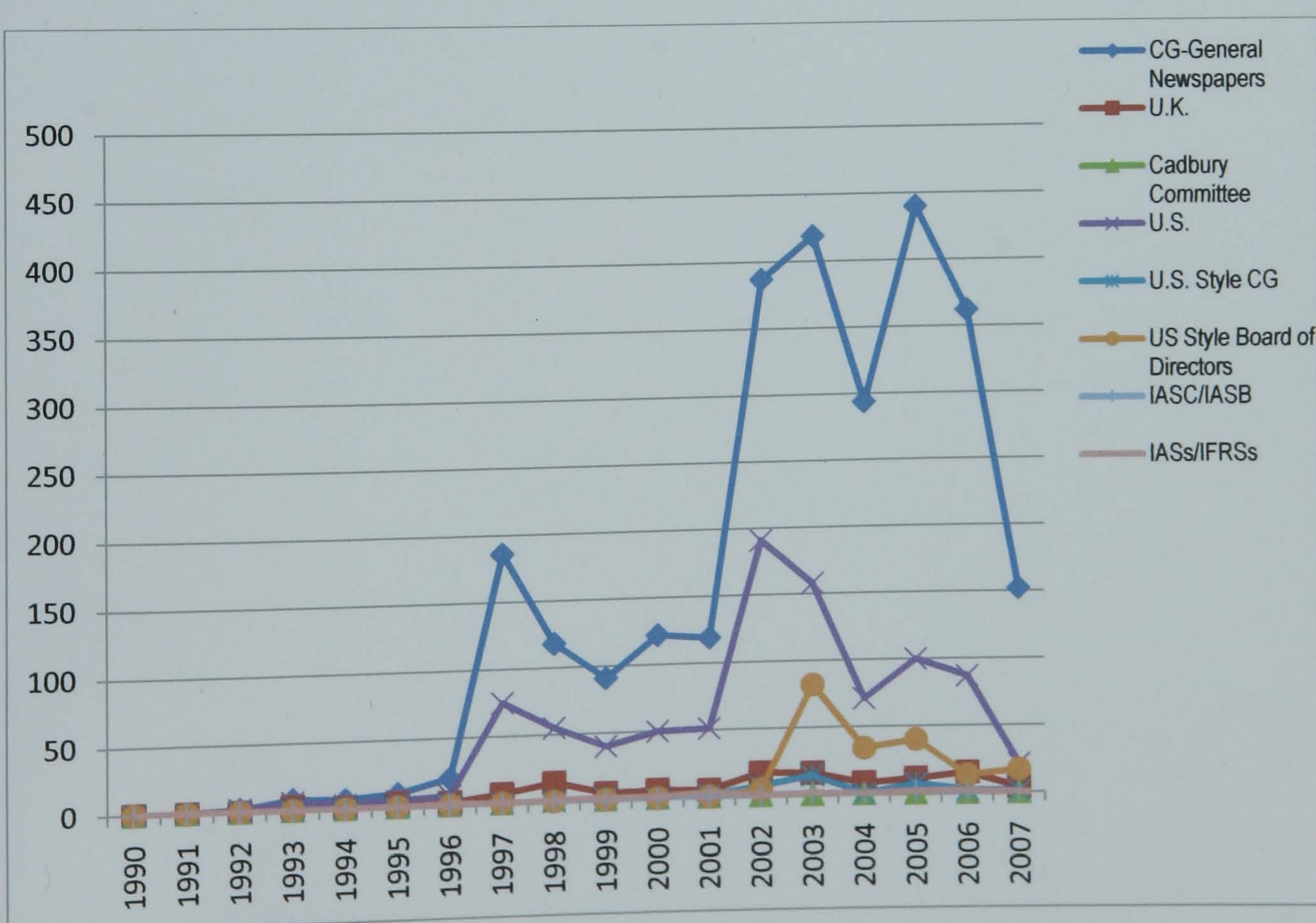

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